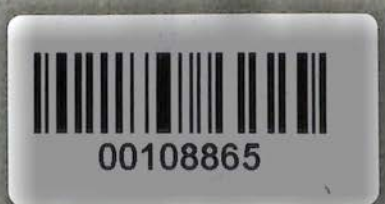
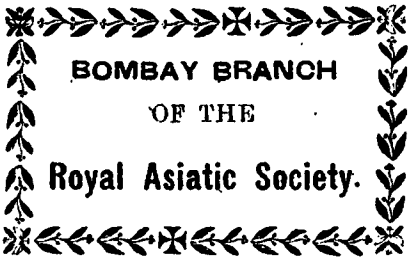

00108865



Digitized with financial assistance from the
Government of Maharashtra
on 26 June, 2018

00108865

REPORT

of the

Committee on National Debt and Taxation.

108865 ac

Presented to Parliament by Command of His Majesty

LONDON:
PRINTED AND PUBLISHED BY HIS MAJESTY'S STATIONERY OFFICE
To be purchased directly from H.M. STATIONERY OFFICE at the following addresses:
Adastral House, Kingsway, London, W.C.2; 120, George Street, Edinburgh;
York Street, Manchester; 1, St. Andrew's Crescent, Cardiff;
15, Donegall Square West, Belfast;
or through any Bookseller.

1927

Price 7s. 6d. net,

Cmd. 2800.

Cost of Report.—The total estimated expenditure incurred in the preparation of this Report, excluding the cost of printing and publishing the Report, Appendices and Minutes of Evidence, amounts to £4,090. The estimated cost of printing and publishing the Report, Appendices and Minutes of Evidence is £410 13*s.*

REPORT OF THE COMMITTEE ON NATIONAL DEBT AND TAXATION.

TABLE OF CONTENTS.

	Page
Minutes of Appointment	viii
Introduction	1

PART I.

SECTION I.—General Conditions: the Standard of Living and the Standard of Saving:

The Standard of Living	3
The Standard of Saving	16

SECTION II.—Growth, etc., of the National Debt:

Debt at 31st March, 1926	24
External debt and its distinction from the internal debt ...	26
Floating Debt	33
Growth and subsequent reduction of other unfunded debt ...	37
Results of conversion operations prior to 31st March, 1926 ...	44
Summary of debt transactions, 1920-21 to 1925-26	48
Issue of loans at a heavy discount	51
Attachment to loans of special taxation privileges	56
Interest charge and prospects of reduction through conversions	59
Relation of price level to the burden of debt	65
The Sinking Funds	67

SECTION III.—The Burden of Taxation, Direct and Indirect, on various incomes 73

SECTION IV.—The Incidence and Effects of Existing Taxes:

Sub-section I.—Taxation and Expenditure: the expenditure side	97
Sub-section II.—Use of the term "Incidence"	106
Sub-section III.—Incidence of the Income Tax	108
Sub-section IV.—Effects of the Income Tax:	
Income Tax and the Individual:	
The principle of progressive income taxation	121
Post-war rates of tax and graduation	123
Residence abroad to avoid tax	127
Effect on the work and enterprise of the employee and professional man	128
Weight of the tax and the standard of living	131
Effect of the tax on saving	136
Income Tax and the Public Joint Stock Company:	
Supply of capital from the public	141
Company reserves	145
Enterprise of companies	150
Transfer of residence abroad, etc.	151
Income Tax and the Private Business:	
Classes of private business and their distinction from the public company	154
Comparison of the private business with the profession, etc.	155
Physical effect of the tax on saving and enterprise ...	156
Psychological effect of the tax on saving and enterprise	158
Transfer of residence abroad, etc.	163
Summary of main conclusions	164

PAGE

SECTION IV.—*cont.*

SUB-SECTION V.—Incidence of the Death Duties:
Estate Duty 169
Legacy Duty and Succession Duty 171
SUB-SECTION VI.—Effects of the Death Duties:
Post-war rates, etc., of Estate Duty 173
Equity of the Estate Duty 177
Treatment of life insurance policies 183
Avoidance of Estate Duty 183
Special cases—the private business 184
do. the agricultural landowner 186
Effect of Estate Duty on saving and enterprise 188
Legacy and Succession Duties 194
The death duties and Government expenditure 197
Summary of main conclusions 198
SUB-SECTION VII.—Incidence and Effects of the Stamp Duties:
Introductory 199
Duty on:
(i) conveyance of land, etc. 201
(ii) transfer of stocks and shares 202
(iii) bearer bonds 203
(iv) companies' share capital 205
(v) cheques 206
(vi) receipts 208
General conclusion 209
SUB-SECTION VIII.—Incidence and Effects of the Customs and Excise Duties:
Introductory 209
General effects of the Customs and Excise duties 211
The weight of the duties and the standard of living:
(i) General 212
(ii) Regression in the indirect taxes... 213
(iii) Indirect taxes and wages... 214
(iv) "Necessaries" and "luxuries" 217
(v) The various Customs and Excise duties 218
(vi) Conclusions 229
The effect of the Customs and Excise duties on saving ... 231

SECTION V.—The Burden of the Debt and Existing Taxation: Broad consideration and conclusions:
Comparative burden in different countries 233
Napoleonic War parallel 234
Future productivity 237
Taxation and the individual 238
Taxation and the citizen 239
Standards of living and saving 240
Business enterprise 242
Savings and employment 242
The general burden 244

PART II.

SECTION I.—The Capital Levy:
Introduction 246
Practicability 247
Scale and yield and resultant annual saving of interest ... 250
The levy and the price level 256
Guarantee against repetition 259
Methods of payment: effect on value of securities 260
Effect on Government rate of borrowing 266
Levy and national credit abroad 267
Effect of levy on bank advances 267

PAGE

SECTION I.—The Capital Levy—*cont.*
Levy and private businesses 273
Levy and agricultural landowners 276
Redistribution of saving power 276
Psychological effects of a levy on saving and enterprise... ... 278
Redistribution of wealth 282
Equity of a levy 284
Summary and conclusion 290

SECTION II.—Schemes of Taxation and Debt Repayment:
A forced loan scheme: forced loans generally 297
Annual tax on capital: increased taxation of investment income 303
Composition for Income Tax 306
Flat rate tax on production, suggested by Mr. P. D. Leake ... 309
Professor Rignano's Death Duties scheme 313
A variant on Professor Rignano's scheme, suggested by Dr. Dalton 316
Proposal by Mr. J. St. Loe Strachey to convert debt into Terminable Annuities 318
Proposals by Mr. Alfred Hoare for the conversion of maturing loans 321
Proposals by Professor A. L. Bowley for varying debt redemption in accordance with the state of employment 323

PART III.

Debt Redemption and Taxation: Conclusions:
(i) Debt redemption 329
(ii) Taxation under the Sinking Fund policy 344

List of Witnesses appearing before the Committee 352

MINORITY REPORT.

PART I.—The Debt and its Effects:
Composition of the debt 355
The interest charge 356
The burden of the debt—external debt 357
" " " " —internal debt 358
The Floating Debt 363
Conclusions as to effects of the debt upon distribution of wealth and income 364
The debt and the price level 364
Comparison with the period following the Napoleonic Wars ... 366
Annexe—Composition of the debt as at 31st March, 1926, and dates of maturity of loans 369

PART II.—Taxation:
General incidence of taxation 371
The principle of taxation upon commodities 371
Recommendation as to indirect taxation 373
Taxation and representation 373
Direct taxation—general 374
Direct taxation and employment 376
Direct taxation and purchasing power 377
Direct taxation and prices 378
Direct taxation and the output of work 379
Direct taxation and the quantity of saving 381
Direct taxation and enterprise 387
Conclusions as to direct taxation 389

PAGE

PART III.—Methods of Debt Reduction: Sinking Funds and Conversions:
The Sinking Funds 390
Reduction of the debt burden by conversion 393

PART IV.—The Capital Levy:
Nature of levy scheme 397
The case for the Capital Levy:
Reduction of debt 398
Net annual saving on the Budget 398
Equitable case 400
The equitable case against a levy 401
First conclusion on the equity of a levy 403
Practical considerations in regard to a levy:
General practicability 403
Problems of valuation 404
Destruction of capital 405
Flight of capital 406
Effect of a levy on the prices of securities 407
Effect of a levy on credit and the general price level ... 408
Payment of a levy by private businesses, etc. 410
The levy and unemployment 410
Conclusions as to a Capital Levy 411
Annexe—Certain aspects of the difference between the gross and net saving from a levy 412

PART V.—Proposed Alternative Means of Debt Reduction:
Proposed Sur-tax on investment incomes 414
Proposals as to death duties:
General views on the system 417
Possibilities of an Inheritance Tax 418
The Rignano proposal for modification of Estate Duty ... 418
Summary of Report 424

RESERVATION to Minority Report by Professor Fred Hall ... 431

Index to Majority Report 435

NOTE.—In addition to this Report, the following volumes are published :—

Appendices to the Report of the Committee.

Minutes of Evidence taken before the Committee.

References.

The following examples show the method of indicating references to the above volumes in the Report of the Committee :—

E. in C. 3 indicates paragraph 3 of the evidence in chief in the Minutes of Evidence of the witness quoted. When the witness appeared before the Committee twice the page of the Minutes of Evidence is also inserted, thus, *Ev. p.* 587 ; *E. in C.* 7,

Appendix VII indicates an Appendix in the volume of Appendices to the Report.

Ev. Appendix VII indicates an Appendix printed at the end of the Minutes of Evidence.

COMMITTEE ON NATIONAL DEBT AND TAXATION.

MINUTES OF APPOINTMENT.

Treasury Minute dated 20th March, 1924.

The Chancellor of the Exchequer states to the Board that he proposes to appoint a Committee to consider and report on the National Debt and on the incidence of existing taxation, with special reference to their effect on trade, industry, employment and national credit.

The Chancellor further proposes that the Committee should be constituted as follows:—

The Rt. Hon. LORD COLWYN, *Chairman;*
Sir CHARLES ADDIS, K.C.M.G.;
Sir ALAN G. ANDERSON, K.B.E.;
Sir ARTHUR BALFOUR, K.B.E.;
Mr. HENRY BELL;
Mr. J. W. BOWEN;
Mr. FRED BRAMLEY;
Mr. W. L. HICHENS;
Mr. J. A. HOBSON;
Mr. H. B. LEES-SMITH;
Sir WILLIAM MCLINTOCK, K.B.E., C.V.O.;
Sir JOSIAH STAMP, K.B.E.;
Mrs. BARBARA WOOTTON;

with Mr. G. R. HAMILTON of the Inland Revenue Department as Secretary and Mr. G. ISMAY of the Treasury as Assistant Secretary.

My Lords concur.

Treasury Minute dated 14th April, 1924.

The Chancellor of the Exchequer states to the Board that he proposes to appoint Professor Fred Hall to be a member of the Committee on National Debt and Taxation in place of Mr. J. A. Hobson who has resigned on account of other engagements.

My Lords concur.

REPORT OF THE COMMITTEE

ON

NATIONAL DEBT AND TAXATION.

To the Lords Commissioners of His Majesty's Treasury.

My Lords,

1. We have now completed our consideration of the wide subject-matter referred to us in the minute of our appointment dated the 20th March, 1924, and have the honour to submit our Report.

2. We have held 48 sittings, and have received evidence from 62 witnesses, several of whom have appeared before us twice. Witnesses eminent in different spheres of industry, finance and economics, have sometimes given expression to their purely personal views, and sometimes represented the corporate opinion of leading industrial, etc., bodies. The views of the Trades Union Congress, of the Co-operative Congress and of the Women's Co-operative Guild have also been laid before us. We have heard official evidence from the Treasury and the Board of Inland Revenue; in addition, both from these Departments and from others—the Board of Customs and Excise, the Board of Trade, the Ministry of Labour, and the Registrar-General's Department—we have received valuable statistics and other information. We may mention that we have not seldom made use of this material for somewhat speculative inferences, and for these we take sole responsibility.

3. We have also received memoranda from various bodies and persons interested in particular aspects of our enquiry. To a number of these we have referred under the appropriate head in our Report; in some cases, however, the points raised appeared already to be fully covered, and in certain others we were unable to regard them as directly relevant to our reference.

4. Shortly after the commencement of our investigation, Mr. J. A. Hobson found it necessary to resign from the Committee in order to fulfil engagements abroad, and Professor Fred Hall, Principal of the Co-operative College and Adviser of Studies to the Co-operative Union, Ltd., was appointed in his place. At a later stage of our proceedings we were deprived of the services of Mr. Fred Bramley, who resigned in March, 1925, on account of ill-health, and died shortly after.

5. A word may be said as to the area covered by our enquiry. Our terms of reference link together "the National Debt" and "the incidence of existing taxation." So far as concerns taxation for the service of the debt, the two terms stand for aspects

of a single subject. Questions of debt policy arise, however, independently of taxation; we have therefore treated the debt and taxation separately as well as in conjunction. Similarly, we have understood the specific reference to the National Debt and its effect on trade, etc., as empowering us to go beyond existing taxes, and give consideration in some detail to large schemes for debt reduction, including especially the Capital Levy. Apart from such schemes we have limited our consideration almost wholly to existing taxes, and have not attempted to explore alternative sources of revenue. The broad lines we have pursued will be clear from the general questionnaire and the questionnaire on the Capital Levy, which we issued to witnesses, and which we reproduce as the first Appendix to this Report. We have regarded questions of a definitely technical character on the assessment of taxes as, in general, outside our reference. We may note that under the head of "existing taxes" we have not directed specific attention either to entirely new taxes imposed in the Finance Acts of 1925 and 1926, or to the New Import (or McKenna) Duties which were re-imposed in the Finance Act, 1925, after being repealed in 1924 at the commencement of our enquiry.

6. The wide character of our task in relation to the debt and existing taxes is made clear by the direction that they are to be considered "with special reference to their effect on trade, industry, employment and national credit." Whatever interpretation may be placed on the term "incidence of taxation"—and for convenience we use it throughout in its narrower economic sense (*cf. para.* 288)—we have to examine the whole range of reactions set up by existing taxes. Emphasis is laid upon the corporate industrial aspect of the community, but the effect upon individuals as individuals is not excluded.

7. In this extensive field questions constantly arise to which there are no answers admitting of anything like mathematical proof. Taxation is pre-eminently a matter on which the opinions of individuals, even when in general harmony, differ by an indefinite number of shades, and are almost certain to come into conflict on some point of more or less importance. We found this to be the case with our witnesses, and we do not pretend that we have been able to eliminate all difference of degree among ourselves, in particular regarding the importance to be attached to the harmful effects of high taxation on enterprise in trade and industry. While, however, those of us who sign this Report may differ on some of the details of argument, we agree substantially in the conclusions.

PART I.

SECTION I.

GENERAL CONDITIONS: THE STANDARD OF LIVING AND THE STANDARD OF SAVING.

8. In view of the concurrent enquiry by the Committee on Industry and Trade, we do not think it incumbent upon ourselves to attempt any review of the general position of industry in its many aspects. In the study of taxation, however, we are so deeply concerned with questions relating (1) to the standard of living of the wage-earner, and (2) to the standard of saving in the community, that we think it well, at the outset, to give some broad consideration to these two subjects. Inevitably, the figures and other evidence which we pass under review will reflect to a large extent the industrial conditions of to-day.

THE STANDARD OF LIVING.

9. *Introductory.*—The phrase " standard of living " is often used as if there were some fixed and absolute scale of comfort to which people have a right. Such a use is misleading. Ideas of what is comfortable or even decent constantly vary from one country and one time to another, and it does not follow, from the fact that a certain standard of living has been attained under one set of economic conditions, either that it can be maintained or that it will prove satisfactory under another.

10. In the nature of the case the notion of an adequate standard must be relative, if only because new commodities create new needs and new desires. The fifteenth century—especially its latter half—has been regarded as the golden age of the English labourer. But while wages were such as to enable the lowest-paid classes to obtain abundant supplies of a few simple foods, the standard of comfort was very low according to modern ideas, and the range of commodities open to all except the rich was exceedingly restricted. The fifteenth century, whatever its admirable features, can certainly not be taken as a guide to the wants of the twentieth.

11. It may be noted in passing that in the sixteenth century (after 1525) a decline took place in the purchasing power of wages and in the standard of living. It was not till the eighteenth century that any great improvement took place, and towards the end of that century there was a collapse. " Whereas the labourer's condition earlier in the century had been contrasted with that of Continental peasants greatly to his advantage in respect of quantity and variety of food, he was suddenly

brought down to the barest necessities of life. Arthur Young had said a generation earlier that in France bread formed nineteen parts in twenty of the food of the people, but that in England all ranks consumed an immense quantity of meat, butter, and cheese. . . . But at this time bacon and other kinds of meat form a very small part of their diet, and cheese becomes a luxury. But even on the meagre food that now became the ordinary fare of the cottage, the labourers could not make ends meet. . . . The normal labourer, even with constant employment, was no longer solvent."*

12. During and after the Napoleonic Wars the position of the labourer was generally one of terrible distress, although it is exceedingly difficult to say how far his sufferings can be traced to the wars, which coincided with serious failures of the harvest and with revolution in the economic life of the country. To whatever extent the wars may be held responsible, it is clear that the standard of living a hundred years ago was extremely low as compared with that existing before the war of 1914-1918 or at any time since. It is worth stressing this fact in face of the opinion that the advantages of the industrial development of the last century have been largely counterbalanced by many new disabilities for the poorer classes. On the other hand, even if men know that they are living better than a past generation, they may still be justified in complaining of their own hardships. The commerce and wealth of this country have expanded enormously in the last hundred years and people may naturally look for a much higher standard of living. We propose, therefore, in this Section, to consider the standard of living to-day and in recent years in relation only to the standard immediately before the outbreak of war in 1914; even here we do not imply any assumption that the pre-war standard was at the highest economic point possible at that time, still less that it had any degree of finality.

13. In order to obtain a proper basis for comparison we shall have to consider not only rates of wages, but also actual total earnings of the individual, so far as these may not be fully represented in rates of wages. We shall also have to consider the bearing of unemployment on the one side and of increased social services, etc., on the other; finally we shall have to give some attention to the relation between the spending and the saving of the wage-earner, and to any changes in the direction of expenditure.

For the sake of clearness we will use the term " earnings " as distinct from " wages," whenever we are concerned with amounts of pay received and not merely with rates of pay. When we speak of wages without qualifying the term we mean money wages: when we speak of real wages, we mean wages measured in terms of purchasing power.

---

* *The Village Labourer, 1760–1832.* J. L. and Barbara Hammond (1920).

14. *Comparative rates of wages; general average for wage-earners in employment.*—As regards the years between 1914 and 1920, Professor Bowley, in his book "Prices and Wages of the United Kingdom, 1914-1920," says:—

> "So far as a general statement can be made, we may say that *rates* of wages for the same work increased less rapidly than the cost of living in the first three years of the war, in the fourth year wages gained and their increase over four years was nearly that of the modified index (i.e., a refinement of the official cost of living index allowing for a modification of purchases in accordance with available supplies without necessarily any lowering of standard). In 1918-19 wages gained rapidly and reached the official cost of living measurement, and they kept pace with it in the year 1919-20. This equality is the result of a balance between a lesser increase in the case of artisans and a greater in the case of labourers."

15. For the post-war period statistics have been provided from time to time in the "Ministry of Labour Gazette," comparing the current rates of money wages with the rates at August, 1914. These statistics, in conjunction with the cost of living index numbers, furnish some general guidance as to movements in rates of real wages up to the end of 1925.

16. The Ministry of Labour point out, however, that these figures relating to money wages must be taken with certain important reservations. The information on which they are based is almost entirely limited to the various standard or minimum rates, which have been fixed by Agreements between particular Employers' Associations and Trade Unions, embodied in Arbitration Awards, and Orders under the Trade Boards Acts, or, in the absence of such formal documents, recognised by the Trade Union concerned. Particular attention is drawn by the Ministry to the fact that variations, independent of general agreements, in the amounts actually paid cannot be estimated, no general investigation into the rates paid by individual employers having been undertaken since 1906.

17. It may be remarked that, since working hours were reduced by about one-tenth* during the years 1919 and 1920, the rates of wages per hour since those years are correspondingly higher than the rates per week which are shown in the figures we quote. On the other hand, the figures take no account of unemployment or short time working. Moreover, they take no account of the effects of increased or reduced exertion on the earnings of workpeople paid at piece-rates of wages, as to which comprehensive statistics are not forthcoming. They relate therefore to *rates* of pay and not to *actual earnings*. Latterly

* This fraction was given by Mr. Layton (*E. in C.* 3), and by Dr. Bowley (*E. in C.* 10).

some further information as to actual earnings in certain industries has become available to the Ministry of Labour, and we shall draw upon this in due course.

18. With regard to the cost of living figures, these are well established as the best available guide,* but they are probably less reliable for the years of inflation, 1920 and 1921, than for the later years.

The following table, which is on the model of Professor Bowley (*E. in C.* 8), brings together Ministry of Labour figures :—

	Weekly rates of money wages for adults.	Cost of living index.	Rates of real wages (mean).
1914 August (beginning) ...	100	100	100
1920 December (end) ...	270 to 280	265	104
1921 " " ...	210 to 215	192	111
1922 " " ...	170 to 175	178	97
1923 " " ...	165 to 170	177	95
1924 " " ...	170 to 175	180	96
1925 " " ...	175	175	100

19. In view of the fluctuation of money wage-rates and prices, a cross-section taken at one point of time does not indicate with any accuracy the level throughout the year. Since, however, the data available are only approximate, the general tendency as between the several years is perhaps as well represented by this table as by any other. Slightly varying results are obtained if the figures for August, 1914, are related to those for the end of June in the post-war years instead of to those for the end of December.

The figures are as follows :—

	Weekly rates of money wages for adults.	Cost of living index.	Rates of real wages (mean).
1914 August (beginning) ...	100	100	100
1920 June (end)	250 to 255	252	100
1921 " "	245 to 255	219	114
1922 " "	185 to 190	184	102
1923 " "	165 to 170	169	99
1924 " "	170	170	100
1925 " "	175	173	101

The lower cost of living in June as compared with December in 1923 and 1924 reflects the normal tendency of seasonal variation, milk, butter and eggs in particular being dearer in winter than in summer. The years 1921 and 1922 were abnormal in this respect owing to broad currency changes.

* For some brief discussion of the index in this Report *see* para. 603 *et seq.*

20. In view of the lag which normally occurs between price changes and wage adjustments it may be of interest to give finally a table showing the estimated average annual figure of wage-rates (based on the arithmetical average of the end of the quarter estimates (mean) of the Ministry of Labour) in conjunction with the average cost of living index for the year.

	Weekly rates of money wages for adults (annual average).	Cost of living index (annual average).*	Rates of real wages.
1914 August (beginning) ...	100	100	100
1920	256	249	103
1921	240	226	106
1922	185	183	101
1923	169	174	97
1924	171	175	98
1925	175	176	99

* Average of the rates ruling on the first day of each calendar month in the year.

21. No very precise inference can be drawn from these comparisons. There are inevitable gaps in the material from which they have been compiled and a fair margin must be allowed for the possibility of error. So far as the figures go, they illustrate the fact that in 1921 the rates of real wages for persons in employment were on the average appreciably higher than in 1914. Apart from that year, they tend to show that the average rates of real wages for persons in employment have not altered considerably since 1914. An apparent movement of one or two points upwards or downwards does not warrant any certain conclusion even as to rates of real wages. Still less does it warrant any inference as to total actual earnings.

22. *Averages for employed wage-earners in particular industries: rates of wages and actual earnings.*—We may now turn from general averages to glance briefly at the position in particular industries. There are two main reasons for doing this. The first is that, especially in industries where payment is largely by piece-rates, there are some indications that actual earnings of individuals in employment may be higher than the mere increases in agreed rates would suggest. So far as this may be true, the average position of the wage-earner may be rather better than any figures based on wage-rates would suggest. The second and obvious reason for looking at particular industries is that while real wage-rates, averaged over the general field, seem to have remained fairly constant, in individual industries they have marked out widely different courses. The very wide disturbance of pre-war levels is a fact of the highest importance.

23. During 1925, while the increase in the cost of living (as shown by the index) varied from 80 at the beginning of the year

to 73 at the end of June and 75 at the end of December, there was comparatively little change in the rates of money-wages in the various groups of industry—less, in fact, than in any year since 1914 : in the present year changes have continued to be on a relatively small scale. Bearing in mind then the cost of living figures, we may get a fairly representative picture of the varying fortunes of different classes of wage-earners by considering rates of money-wages at the end of June, 1925, and, as far as possible, actual earnings. We give some details in Appendix II, basing our figures mainly on the statistics supplied by the Ministry of Labour to the Committee on Industry and Trade, and published by the latter in their *Survey of Industrial Relations* (1926).

24. The figures go to show that in industries of the " sheltered " type rates of money wages have generally increased more than the cost of living, the excess being sometimes very marked. In the export group, rates of time-wages and piece-wages appear in some cases, especially as regards labourers, to have advanced as much as or more than the cost of living, but in many industries and for many classes of worker the advance has been less than the advance in the cost of living. Attention is called, however, to indications that the actual earnings of those in employment—e.g., in the iron and steel and the textile trades—are greater, and perhaps considerably greater, than piece-rates would suggest.

25. The Ministry of Labour suggest various reasons which may account for an increase in the earnings of piece-workers greater than the increase in their piece-rates : among the possible reasons are changes in organisation, in machinery and plant, and in methods of manufacture : other changes, which may affect the average level of earnings in an industry, whether time-rates or piece-rates prevail, are changes in the proportions of skilled to unskilled, male to female, and adult to juvenile employees. The resultant of such changes would not be reflected in the average figures, based on wage-rates as distinct from actual earnings, shown in the tables we have given in paragraphs 18 to 20.

26. Certain passages in Mr. W. T. Layton's evidence, while directly concerned with the total product of industry and not with the wage-earner's share, go to support the view that the earnings of piece-workers may be greater than a comparison of rates would suggest. He did not agree with Professor Bowley in taking productivity to have fallen in the same ratio as the reduction in total working hours : while there had been reductions in very many occupations, it would be true to say that in the majority of cases they had not been followed by a corresponding reduction in output. The saying that in the Lancashire cotton trade, owing to its mechanical perfection, output per hour could not be increased was open to doubt, and even if it were true, the cotton trade was certainly not typical in that respect. In all the metallurgical groups the output per man-hour was better in 1924 than in 1914. Mr. Layton had

made a few personal enquiries which led him to the following conclusion : " The cases I have selected show that, though there is considerable variation, on the whole, production per head per hour is better than before the War, but has not improved sufficiently to make good the loss of working time. When, however, we consider processes of production as a whole, I am sure we shall find from the census of production that the loss from reduced hours has been made up." (*E. in C.* 4.)

27. We are disposed to think that the difference between movements in actual earnings and movements in rates of wages may be a factor of no little importance in considering averages over the whole field of employment. According to the table in paragraph 20, the average for the rates of real wages over the four years 1922 to 1925 was only 1·25 points below the level of August, 1914 : the figure for 1925 was 1 point below August, 1914. In view of the margin of error attaching to these figures, and of the evidence in regard to piece-work, it may well be the case that the real earnings of persons in employment have, on the general average, been somewhat higher than in 1914. A broad feature of the disturbance in wage-levels is that unskilled workers have improved their position relatively to skilled. There seems to be no doubt that the average real earnings of the unskilled worker are appreciably higher than before the War.

28. *Unemployment.*—Up to this point we have dealt only with the employed wage-earner, but it is of course essential, in considering the general standard of living, to keep in view the serious figures of unemployment. In Appendix III we give two tables showing the numbers recorded on the registers of employment exchanges in Great Britain from January, 1921, onwards, and the percentages unemployed among insured workpeople over the same period. We give here, from the Ministry of Labour Gazette, the numbers recorded as unemployed at quarterly intervals since July, 1923 :—

Month (end of).	Numbers Unemployed.	Month (end of).	Numbers Unemployed.	Month (end of).	Numbers Unemployed.
1923.		1924.		1925.	
July ...	1,279,144	July ...	1,091,293	July ...	1,258,657
October ...	1,302,662	October ...	1,232,555	October ...	1,287,733
1924.		1925.		1926.*	
January ...	1,331,153	January ...	1,270,708	January ...	1,251,831
April ...	1,076,605	April ...	1,225,094	April ...	1,034,516

* Owing to the reactions of the situation in the coal industry recent figures have shown a large increase. The figures were 1,683,195 for the end of June, and 1,672,193 for the end of July.

As would obviously be the case, figures for particular industries show wide variation. The Ministry of Labour show that approximately 42 per cent. of all insured persons are employed in industries subject to greater unemployment in the winter than in the summer. Apart from this factor, the general tendency in those industries has been towards improvement. The building trade (where wages have advanced well beyond the increased cost of living) is the foremost example of a seasonal industry. Next to it the most affected are the clothing and furniture industries and the food industries. Those affected in a lesser degree include the railway services, in which rates of wages have made a strong advance.

29. The Ministry of Labour's analysis of the position in October, 1925, showed that in the staple manufacturing industries, producing largely for export (where real wages have generally fallen as compared with 1914), unemployment was bad over most of the field. When coal-mining is left on one side, the shipbuilding industry had suffered worst, approximately 37 per cent. of the numbers estimated to be insured at July, 1925, being recorded as unemployed at the 26th October, 1925. Iron and steel come next, and then engineering, which covers marine engineering, where employment had been bad, and electrical engineering, &c., where it was much better. In shipbuilding, iron and steel and engineering taken together, 20 per cent. were unemployed at the 26th October, 1925. In the textile industries, cotton and wool, the percentage was only 8·1. The Ministry state that in the whole group of five together there had been distinct improvement during the preceding two years, in spite of the acute depression in iron and steel, shipbuilding and marine engineering.

30. It is to be noted that the aggregate number of unemployed in all insured trades other than coal-mining was 61,700 less in October, 1925, than in October, 1924, but in coal-mining alone there was excess unemployment of 116,878. Recently the country has suffered from a general strike and a coal dispute, and also from the collapse of the French and Belgian francs abroad. Apart from these impediments it looks as though the improvement of 1924 would have continued.

31. The conclusion we draw is that the facts of unemployment accentuate the inequality in different industries which we have noticed in discussing rates of wages and earnings. While the average real earnings of persons in employment may perhaps be somewhat higher than in 1914, the increase in unemployment and also in short-time employment, must depress the average for the whole working population.

32. *Social services and other supplements to earnings.*—We have now, in our comparison with 1914, (1) considered average rates of wages, and average earnings, for those in employment, and (2) glanced at unemployment as affecting the average earnings of the population. A third element enters into any

comparison of spending power, viz., receipts, whether in cash or in kind, other than earnings. In this category, besides income from invested savings (including the enjoyment of house property owned by the occupier), there fall unemployment relief, health benefits, pensions, &c. The marked increase in the social expenditure of the State has undoubtedly been a material support to the spending power of the working-class population. Moreover, there has been a notable increase in superannuation and pension funds set up by employers for the benefit of workpeople and their dependants, and also in other forms of welfare provision.

33. *Total resources: relation of spending to saving.*—From the various evidence reviewed we can only infer that, on average, the total resources of the wage-earning classes do not differ much from their pre-war level. The statistical evidence available is very imperfect, and in our view does not justify any confident answer to the question whether the working population as a whole are slightly better off or slightly worse off than they were in 1914.

34. Statistics from which we have quoted in Appendix II appear to show that so far as the unskilled worker is concerned, real earnings have on the average, though not in every industry, increased. It might be anticipated that such an increase in the lowest ranges of incomes, and also the increase in pensions, etc., which we have noted, would be almost entirely devoted to an increased consumption, with a pronounced effect upon the standard of living. Again, it might not unreasonably be anticipated that some part of the reduction in the real earnings of skilled workers would be found to have depressed the savings of those workers rather than their consumption. In other words, the more even spreading of resources between skilled and unskilled raises a strong presumption that, if it were possible to measure spending and saving, spending would be found to be in a higher proportion to saving than before the war; given the same total resources per head, this would imply some improvement in the immediate standard of living.

35. A difficulty is that the evidence as to working-class savings to be derived from Post Office and Trustee Savings Bank deposits and National Savings Certificates does not suggest any failure of per head savings to keep pace with the cost of living. *Prima facie*, it might seem to suggest a slight advance beyond the cost of living increase, but the figures are far from conclusive: moreover, the view that per head savings have increased more than in proportion to the cost of living does not appear to be supported by Co-operative Society figures (*para.* 57).

36. Summing up, we may say that pure statistics as to resources on the one side (account being taken of wage-rates, actual earnings, unemployment, social services, etc.), and as to savings on the other, might lead to a tentative inference that if anything, rather less was being spent on the average; this would

imply that, apart from certain points still to be considered, the average standard of living was slightly lower than before the War. The statistics, however, are so incomplete, they relate to so many different fields, in each of which there is a possibility of important error, and they point to so small a balance of change either way, that they do not, in our opinion, justify such a conclusion. It is easy to let the comparative figures for rates of wages in paragraphs 17 to 20 have too much influence on the mind. In this connection we may note an answer given by Professor Bowley to the question whether his comparative statement would remain undisturbed if all the readjustments of wage-rates were recorded. He said that certainly he did not know in what direction it would be disturbed. His real wages estimate for August, 1924, of 100 (i.e., equal to pre-war) might well be some few points out on either side (Q. 3824; cf. Q. 3690).

37. *Evidence as to consumption.*—Further, if adequate statistics as to consumption were available, it seems likely that they would be quite inconsistent with any lower standard of living. Certain indications may be noted. There has been a remarkable increase in the consumption of tea* per head—6·8 lbs. in 1913-14 and 9 lbs. in 1925-26—and the Food Council, in their recent Report on Wholesale Tea Prices (*para.* 28) say that all the witnesses whom they have examined state that there is very little demand for the cheaper kinds of tea in this country, and that of recent years the consumer has learned to prefer a better quality of tea to the cheaper grades. There is similar evidence of a demand for better quality in the case of meat. The Royal Commission on Food Prices concluded that the aggregate consumption per head was much the same in the years immediately preceding the War; they noted the existence of a tendency —even if exaggerated by some of their witnesses—for the demand for cheaper cuts to fall off. (Cmd. 2390, *paras.* 184, 186, and 188). Evidence as to bread tells in the same direction. The reduced consumption suggests that the worker may be buying a wider range of cereal and other foods, and this idea has recently been prominent in trade journals. Again, a remarkable increase has taken place in the consumption of tobacco (*cf. para.* 635).

38. *General observation: opinions on the standard of living.*—Altogether, in the present rather conflicting state of the evidence to be drawn from statistics, we find ourselves thrown back, as a matter of common sense, upon the evidence of our own and other people's observations. There has been a certain conflict in the evidence from various witnesses. Mr. Walkden, principal witness on behalf of the English Trades Union Congress, stated that, on the whole, the information of the Congress was that

* The increased drinking of tea is probably connected with the decreased drinking of beer and spirits (*cf. para.* 621). But it appears that *expenditure* on intoxicating liquor has more than kept pace with the rise in the cost of living index: reduced consumption, therefore, does not provide any extra margin for expenditure on tea.

the standard of living was rather lower than before the War, real wages not being up to the pre-war standard on the whole in the largest industries (Q. 3106). Bailie James Walker, appearing on behalf of the Scottish Trades Union Congress, emphasised the continuance of distress in industrial areas in Scotland. His fellow witness, Mr. Duncan, speaking from his experience of rural areas, was of opinion that in such areas there had been a general improvement in the standard, and that outside purely industrial areas wages had improved (Q. 2859). Several witnesses had formed the opinion from their own personal observations, that the workers' standard had in general very distinctly improved (*cf. Layton*, Q. 2523 *et seq.* and *Bowley*, Q. 3733). For our part, we think that the signs of improvement, which have impressed many observers, are convincing, although it is doubtless possible to rate them too high. Causes contributing to a better standard may perhaps be found in changes in the size of the wage-earner's family and in the goods and services on which he spends his money.

39. *Size of family: welfare.*—Owing to the fall in the birth-rate the average number of dependent children per family is less than in 1914: children under 15 are shown by the census records to have fallen from 30·64 per cent. of the total population in England and Wales to 27·72 per cent. in 1921. Some set-off must be allowed for an increase in the proportion of other dependants, for persons aged 65 and over increased from 5·20 per cent. of the total population in England and Wales in 1911 to 6·04 per cent. in 1921.* It appears likely, however, that the reduced size of the young family may have contributed not a little to improved conditions.† Further factors making for improvement are maternity and child welfare (*cf. Duncan*, Q. 2859).

* The following table shows the proportionate age and sex distribution of the population of England and Wales in 1911 and 1921 :—

	1911.	*1921.*
Total	*10,000*	*10,000*
Persons aged 0–15	3,064	2,772
15–40	4,182	4,002
40–65	2,234	2,622
65 and over	520	604
Males (total)	*4,837*	*4,771*
aged 0–15	1,533	1,395
15–40	2,011	1,865
40–65	1,069	1,251
65 and over	224	260
Females (total)	*5,163*	*5,229*
aged 0–15	1,531	1,377
15–40	2,171	2,137
40–65	1,165	1,371
65 and over	296	344

† This inference derives strong confirmation from the evidence in "*Has Poverty Diminished?*" by Prof. A. L. Bowley and Miss M. H. Hogg (1925).

40. *Changes in direction of expenditure.*—Visible expenditure may sometimes be an uncertain guide. For instance, while lack of proper house accommodation may compel some poor families to live in houses with rents disproportionately high in relation to their incomes, it may have quite a different effect on others; it may lead to their living in crowded conditions, and in such cases some of the money saved in rent is doubtless spent in the cinemas and the shops. Another aspect of the housing shortage is that it has led to increased letting of rooms by poor persons, the lodgers' rents going to augment family incomes: here, again, there is less comfort, but there is something extra to spend. Altogether it seems likely that the relatively lower net expenditure on rent may set free a considerable amount for other expenditure, but on balance the change may be of doubtful benefit to the standard of living.

41. In some districts where large sums are distributed in out-relief, medical officers have reported a considerable improvement in the physical condition and general welfare of the children, largely due no doubt to the system of part distribution in kind. It can hardly be assumed that the worker's pre-war standard was, for the expenditure represented, the best which could have been devised. Even if it was so, it does not follow that the same outlay now would produce the best results, since the prices of alternative commodities (e.g., home and foreign meat) are no longer in the same relationship to one another. The cost of living index was designed to produce a figure showing the average percentage increase in the cost of maintaining unchanged the pre-war standard of living of working-class families (irrespective of its adequacy). It is to be surmised that increases in the prices of some of the commodities entering into the index have induced readjustments of expenditure, so as to enable a larger quantity of consumable commodities to be purchased without adverse qualitative effects on the standard of living. A diversion of consumption from a heavily-weighted article to a lightly-weighted article might have this effect.

42. We have referred to the increased drinking of tea and the decreased drinking of beer and spirits. The reduced consumption of these latter must, we think, make for social well-being. Again, we think there is some force in Mr. Layton's suggestion that " the quality of what the mass of the people can purchase with the margin of their income over what they have to spend on food, necessaries and houseroom, has very greatly improved." Such things as cinemas, wireless, etc., were instanced (Q. 2525). Some allowance must also be made for the income of enjoyment which continues to be derived from various goods, e.g., furniture and pianos, bought in the war and post-war period of high earnings.

43. *Conclusions.*—Our conclusions* as to the position of the working population may be summed up very briefly under a few heads :—

(1) For the employed wage-earner it appears from the purely statistical evidence that real earnings are on the general average much the same as in 1914, and, in view of considerations affecting piece-work, they may well be higher.

(2) In relation to the working population as a whole, increased unemployment is a seriously depressing factor. On the other hand, earnings are more largely supplemented by unemployment relief, health benefits, pensions and other welfare provision.

(3) There have been great changes in the relative position of workers in different industries. Both in rates of wages and in steadiness of employment those in sheltered occupations have usually, but not always, bettered their position relatively to those in industries open to foreign competition.

(4) The earnings of unskilled labour have generally improved relatively to those of skilled.

(5) The last-mentioned fact raises a presumption that if spending and saving could be measured, spending would prove to be in a higher proportion to saving than before the War. Certain statistical evidence seems, if anything; rather contrary to this view, but it is far from conclusive.

(6) Purely statistical evidence as to the total resources and total savings of the working population may seem to suggest that rather less is being spent than in 1914. But the evidence is too defective to justify such a conclusion, and, moreover, indications as to the consumption of various important commodities tell in a contrary direction.

(7) General observation points, on the whole, to some improvement in the standard of living. Such an improvement, which we believe to exist, may be partly due to the smaller size of families, and to changes in the direction of expenditure and the quality of goods available.

(8) The evidence is insufficient to yield precise or dogmatic conclusions. Balancing the various considerations before us, we can only conclude that if the worker's average standard of living differs from that of 1914, it is probably rather higher than lower. The present position is, however, that while in some industries large numbers have secured an improved standard, in others very many have suffered a reduction. There are thus great changes, and the position of the less fortunate is aggravated by the memory of the high pay in the period of boom following the War.

44. *The earnings of the wage-earner and total production.*—We must add a note relating the earnings of the wage-earner to

* From further evidence, which has not been before the Committee, and which depends on the use of very recent material, I have formed the personal opinion that the statistics now available point to a more definite and appreciable improvement in real earnings and in the standard of living than is here indicated.—*J. C. Stamp.*

the total product of industry and the national income. Mr. Layton, who perhaps represents the most optimistic section of expert opinion, put 1923 production at 95 per cent. of 1913, and had " a very strong instinct " that 95 per cent. was too low.* (Q. 2454.) Professor Bowley, on the other hand, has put 1923 as low as 87 per cent. These divergencies illustrate the serious disability under which statisticians have laboured arising from the lack of adequate data such as a census of production may partially remedy. When, however, the census now proceeding has been completed, it is not likely to necessitate a revision of the view that over the past four years the standard of production and, correspondingly, the national income have fallen as compared with pre-war, and that a larger share of the product of industry has been taken by labour. Professor Bowley suggests that this may in part be accounted for by the lower share of " incomes depending on fixed rates of interest or fixed rents. There is no general evidence on the question whether the proportion received in profits or salaries has permanently changed, though there is little doubt that the share of profits in the current period of depression has been diminished." (*E. in C.* 12.) Mr. Layton points to similar considerations, and concludes : " All that one can say is that there is a section, mainly of the Income Tax paying class, who quite clearly are worse off, and I think the loss of the national income is attributable partly to the loss of a particular section, of which I do not attempt to estimate the size, of the Income Tax paying class, and partly to the fact that there is less saving." (Q. 2534.) It is evident that no clear-cut, precise and full explanation is possible, in the present state of statistical information. It is possible that a contributing cause is to be found in the effects of high and progressive income taxation in restricting the consumption of the Income Tax paying classes (*cf. para.* 351 *et seq.*).

THE STANDARD OF SAVING.

45. As Mr. Layton observed (*E. in C.* 15 (*b*)), there has never been an exact test of national saving. While, however, we could wish for fuller statistics, estimates that have been made of savings before and since the War may be taken as a fairly satisfactory guide to the comparative position. For 1913 total national savings have generally been put at from £350 millions to £400 millions. There will be better material for judging of the present time, when the Census of Production now being prepared is complete. Until very recently the tendency has been to put national savings during the post-war depression very low indeed, but more mature consideration has seemed to justify an estimate of something like £450 millions to £500 millions, and a figure in this range of magnitude has won some acceptance (cf. Q. 9241). The lower figure, £450 millions, was put forward in the *Economist* of the 10th October, 1925. The higher was

* As Mr. Layton added (Q. 2461) total production ought to be 106% of 1913 in order to reach the same level per head of the population.

suggested in evidence before us by Mr. W. H. Coates, who, while he thought it was possible, in spite of difficulties, to get a pretty close estimate, was prepared to modify his figure 10 per cent., either upwards or downwards. We are disposed to think that a figure of £450 millions to £500 millions represents the best estimate than can be made with the data available.

46. The equivalent of pre-war savings of £350 millions to £400 millions would, at the mean, be some £650 millions, when account is taken of the higher prices and increased population. Thus, while nominal savings have increased, real savings exhibit a decline which may amount in present money values to something like £150 millions to £200 millions. It is fair, however, to remember that the comparison is between unlike periods, the immediate pre-war period having been one of booming trade in contrast to the recent years of depression.

47. The only detailed estimate we have had before us was given by Mr. Coates (*E. in C.* 20), his figures, which relate to 1924, being as follows :—

	£ millions.
Internal new issues for investment in the United Kingdom	89
Internal new issues for investment abroad	135
Addition to National Savings Certificates	3
Increase in Treasury holdings of Bonds tendered in payment of Death Duties	9
Investments sold by the banks	35
New houses	35
Profits not distributed by companies and private traders but invested in own businesses; and miscellaneous ...	194
	500

It will be observed that the first two items (new issues) and the last (undistributed profits, etc.), account together for 83 per cent. of the total. We may consider these main elements of saving in the light of certain other evidence put before us, taking undistributed profits first.

48. *Undistributed trade profits.*—The estimate of £194 millions, almost entirely representing undistributed trade profits, was based by Mr. Coates upon " tentative figures which were extracted from official sources for the purpose of giving particular information asked for in the House of Commons." The figure excluded investments made by traders in stocks and shares outside their own concerns, these being comprised in the new issues items (*E. in C.* 22). It is an impressive total, but is on a scale amply confirmed by estimates, based on sample investigations, which the Board of Inland Revenue supplied to us for 1922 and 1923, along with comparable figures for 1912. The Board were careful to point out that these estimates were subject to a margin of error which might be considerable, and that their representative character was limited by the fact that they

related to no more than one pre-war and two post-war years. Unlike the figures of Mr. Coates, the Board's estimates, which we give below, (*a*) are confined to company reserves, as distinct from reserves of private traders trading alone or in partnership, and (*b*) do not attempt to exclude investments made in outside stocks, or indeed to analyse the reserves in any way according to their employment.

——	1912.	1922.	1923.
	(£ millions.)	(£ millions.)	(£ millions.)
Balance of undistributed income.	102·1	219·0	217·5
Deduct Income Tax thereon (at 1*s.* 2*d.* for 1912, 5*s.* for 1922, and 4*s.* 6*d.* for 1923).	6·0	54·8	49·1
Net balance	96·1	164·2	168·4
Index of net balance...	100	171	175

The Board also gave us figures of total trading profits of companies, enabling net reserves to be related to them as follows :—

——	1912.	1922.	1923.
	(£ millions.)	(£ millions.)	(£ millions.)
Total trading profits before deduction of Income Tax.	312	462	474
Total profits after deduction of Income Tax.	294	347	367
Total net reserves	96·1	164·2	168·4
Ratio of net reserves to net profits.	33 %	47 %	46 %

49. A general conclusion from these figures, at least for the selected years, is that, although net profits have not expanded in proportion to the rise in prices, reserves have managed to keep pace. If the figures of 1922 and 1923 are reduced to 1912 values by reference to the *Statist* wholesale price index, the following results are shown :—

Adjusted by reference to *Statist* index.

——	1912.	1922.	1923.
	(£ millions.)	(£ millions.)	(£ millions.)
Profits before payment of Income Tax.	312	300	312
Profits after payment of Income Tax.	294	226	242
Net reserves	96·1	106·7	110·7

50. A similar conclusion as to the maintenance of the pre-war level of this class of savings was also reached by Mr. Layton, on the basis of *Economist* figures for five years before the war and five years after the war. The increased percentage of net profits put to reserve as shown by the figures quoted above is noteworthy. It may be read as implying merely a determination to maintain reserves at their pre-war level. On the other hand, it may perhaps point to an increasing tendency for industry to finance itself out of its own profits. Mr. Keynes had formed the impression that such a tendency was at work (Q. 3902), and Mr. Coates was confident that it was so (*E. in C.*: 24; Q. 9452 *et seq.*)

51. Aggregate company savings may then be viewed with some satisfaction. As we have seen, however, in dealing with the standard of living, the maintenance of a general level may mask a great diversity of movements up and down in particular departments. We should expect to find a marked falling-off in the reserve provision of the heavy basic industries, and a relatively improved position in the " sheltered " industries. The Board of Inland Revenue supplied us with some analysis of their total estimates, enabling us to give the following figures. Producers and manufacturers as a whole appear to have maintained their position well; the aggregate net amounts which they are estimated to have put to reserve are £48·8 millions in 1912, £87·2 millions in 1922 and £85 millions in 1923. Within this whole group the mining, iron and steel and associated industries are in a much less fortunate position, the figures being £22 millions for 1912, £19·5 millions for 1922, and £28·3 millions for 1923; the textile industries are estimated to have put a net £8·1 millions to reserve in 1912; 1922 shows the satisfactory figure of £17·4 millions, but in 1923 there is a drop to £12·5 millions. Transport (including shipping)—taken as a second group—shows a falling off from £10·8 millions in 1912 to the low figures of £5·4 millions in 1922, and £6·9 millions in 1923. We are left with the distributive trades (wholesale and retail), and finance and insurance—all known to have been relatively prosperous—and a miscellaneous group, consisting most largely of concerns whose main assets are abroad. The estimated totals for these groups are £36·5 millions in 1912, £71·6 millions in 1922, and £76·5 millions in 1923.

52. The figures we have quoted are throughout exclusive of the allowances granted under the Income Tax Acts in respect of the wear and tear of plant and machinery. The Board of Inland Revenue point out that these allowances, which are very considerable, " may rightly be considered as a fund, freed from Income Tax, at the disposal of companies for maintaining their industrial equipment, a fund out of which machinery, ships, etc., when obsolete and worn-out, can be replaced without drawing on reserves accumulated out of taxed profits " : they add that the allowances should be taken into account, " if regard is to be had

to the total sums available for the preservation and development of industry." This reminder is particularly needed in the case of transport where the allowances for wear and tear are estimated to have reached the high totals of £10·3 millions in 1912, £18·7 millions in 1922, and £17·1 millions in 1923.

53. The most serious factor in the position is clearly the decline in the internal savings of the heavy industries, which, in addition to providing essential plant and machinery for home trade, manufacture so largely for export; the transport position is also very unsatisfactory. The general maintenance of company savings, therefore, while a ground for satisfaction, does not justify any complacency.

54. *New issues.*—It is in the subscriptions to new issues that the main deficiency in current savings must be looked for. We were given figures for the pre-war and post-war quinquennia by Mr. Layton, according to which, if the high figure for 1920 (£330 millions) be excluded, the average nominal amount is about the same. Mr. Layton regarded the current nominal figures as " if anything slightly below those for representative years before the war." While new issues do not necessarily represent a net addition to national savings, for they cannot be dissected so as to exclude all foreign subscriptions or—with certainty—shares taken up by those already in ownership of the business, or again capitalisation of bank loans, the comparative figures so far as they go, suggest a slower rate of saving (*E. in C.* 15 (*b*) (ii)). At their face value, indeed, they suggest a decline of something like £100 millions after adjustment by reference to wholesale prices. If the figures could be purged of all elements other than genuine new savings, the resultant difference might be found to be considerably higher. In any case it must be noted that, as subscriptions by companies and other bodies are included, no clear light is thrown on the savings of individuals.

55. Dealing with the character of savings, Mr. Layton gave the following table analysing new issues of 1913 and of 1921 to 1923 as tending to confirm the " general expectation that the public is playing for safety." (*E. in C.*, 17.)

New Home Issues for Industrial Purposes.

—	Ordinary.	Preference.	Debenture.	Total.
	(£ millions.)	(£ millions.)	(£ millions.)	(£ millions.)
1913	20·0	20·6	13·0	53·6
1921	17·9	14·4	56·8	89·1
1922	12·3	12·9	50·4	75·6
1923	14·0	15·2	37·8	67·0

The large figures for debentures are not, we think, wholly to be ascribed to a playing for safety. The marked increase in 1921

and 1922 is to be ascribed, in part at least, to the inability of companies to place ordinary shares, and to some slight shifting in the relative content (as to security and yield) of the term debentures.

56. In regard to investment abroad, Mr. Layton pointed out that while " in the five years before the War there were £482 millions of foreign investments and £381 millions of colonial investments, in the five years since the War there have been £145 millions of foreign investments, and £321 millions of colonial investments." (*E. in C.*, 18.) Here, again, allowance must be made for the abnormal character of the post-war years—the lack of foreign demand owing to disturbed conditions, and also the embargo on foreign loans in force for part of the period. Nothing can be inferred as to the future course of foreign and colonial investment.

57. *Working-class savings.*—It is difficult to assign the relative shortage in savings to any particular section of the community. There are no satisfactory statistics of working-class savings. We give in Appendix IV tables showing the Post Office and Trustee Savings Bank deposits from 1913 onwards, and also statistics of National Savings Certificates. These might seem to suggest that, despite the prevalence of unemployment and the apparently improved standard of consumption among the employed, the worker is, on the average, saving not less but slightly more than in pre-war times. We agree, however, with Mr. Layton that the figures of the savings banks do not lead to any definite conclusion as regards savings out of current earnings, both because (as he points out) the increase in their funds can be accounted for by the surplus of interest received over interest paid (Q. 2493), and also because depositors are not confined to members of the working-classes. The accounts of building societies are similarly inconclusive, and the figures of co-operative societies, so far as any inference can be drawn from a comparison of the share capital per head, do not point to increased savings. Again, the statistics of Savings Certificates afford no safe guidance. We note that the Montagu Committee of 1922 were only able to express the opinion that " at least half " of the total sold up to the 31st March, 1922, represented subscriptions by those classes whose needs the certificates were primarily intended to meet. (Cmd. 1865.) It is certain that a very large volume is held by classes outside those we are now considering, but in the absence of statistics no very definite inference can be drawn.

58. *Savings of the Income Tax paying class.*—Working-class savings, however, form a small percentage of the total savings by individuals. There has evidently been a decline in saving in the Income Tax paying classes as a whole, but there is no clear evidence for its allocation. We shall consider later what influence taxation is likely to have had. Here we may note that, as Mr. Layton pointed out (*E. in C.*

15 (b) (i)), a class of savings which has been well maintained is that of life insurance. Life insurance may be regarded as a kind of thrift especially practised by the possessors of small and moderate incomes; this is borne out by the relatively high proportion of policy moneys in the smaller estates liable to Estate Duty. But if such persons insure as much as they did formerly, it does not by any means follow that their total savings have kept up to the old level. Provision for life insurance is commonly regarded as a first claim on the savings of moderate incomes, and it is the balance available for free investment which is most likely to suffer either from a contraction of income or from freer spending. Moreover, it may be the fact, as Mr. Layton thought it probably was, that the habit of life insurance is increasing (Q. 2570), and certainly the Income Tax laws encourage people to invest in this direction.

59. We do not think there are any reliable data for a comparison of spending now and before the War. Many people have formed the opinion from their own observation that extravagance and luxury have increased, but this may merely mean that pleasure-spending has become more socially obtrusive than before, without having necessarily grown in amount. Thus, it may be that there is more lavish expenditure in restaurants, dancing, etc., but that this is more or less balanced by reduced expenditure at home; some confirmation may be found for this idea in the decreased number of domestic servants—1,149,000 in 1921 as compared with 1,314,000 in 1911.

60. *Conclusion.*—Generally we conclude that the falling off in the national savings, equal to £150 millions or £200 millions at present-day prices, gives ground for anxiety but not for pessimism. It would be unreasonable to expect that in a period of severe trade depression, due to deep and world-wide causes, there should be an abundant flow of savings. It is not clear from the general trend of the evidence before us that the diminished flow has been inadequate to meet current trade demands. When those demands increase, we do not doubt that savings will answer to the stimulus; but the need for capital may be very great, and it would be unwise to assume that there will be no shortage.

SECTION II.

THE GROWTH, &c., OF THE NATIONAL DEBT

61. In dealing with that part of our reference which requires us to consider and report on the National Debt, we propose to arrange our examination in the first place according to the following divisions :—

(*a*) The composition of the debt as at the 31st March, 1926;

(*b*) The external debt and its distinction from the internal debt;

(*c*) The special features of the Floating Debt;

(*d*) The growth of the internal debt during the War period and the reduction since made;

(*e*) The results of conversion operations;

(*f*) The policy of issuing loans at a large discount;

(*g*) The attachment of special taxation privileges to loans;

(*h*) The interest charge and the prospects of a decrease therein as the result of conversion operations;

(*i*) The relation of the price level to the burden of the debt;

(*j*) The present Sinking Fund and its allocation.

62. We are concerned not so much with the consideration of the merits or demerits of operations now past as with the position which they have brought about, and the questions of future policy to which they give rise. To some extent, however, account has to be taken of the effects of contractual obligations in respect of loans already issued, and of certain other features of the finance of the war and post-war periods. These points are dealt with in the body of our Report, but we have for convenience of reference also shown in an Appendix (No. V) the growth and subsequent reduction of the debt year by year and the main features of the several loans issued.

63. We limit our enquiry almost entirely to that part of the National Debt commonly known as the deadweight debt, against which no particular assets are held, as distinct from the Other Capital Liabilities, which represent borrowings for reproductive

NOTE.—Throughout this section of our Report, the latest figures of debt quoted are those at the 31st March, 1926.

purposes or for capital works of a durable nature. The creation of new debt of the latter category is at present practically limited to borrowings for the extension of the telephone system and for the temporary financing of the Unemployment Insurance Fund, and the interest and repayment charges are in almost all cases provided out of Votes of Parliament instead of, as with the deadweight debt, out of the Consolidated Fund. These borrowings are now raised entirely from the National Debt Commissioners, and, though diverting funds in the hands of those Commissioners which might otherwise be invested in other Government issues, they are obviously of minor importance in relation to the question with which we have to deal.

64. The deadweight debt itself is usually divided into three categories—the funded debt, terminable annuities, and the unfunded debt, in which the Floating Debt is generally distinguished. The funded debt comprises those loans which have no fixed date for repayment, the stockholder having therefore no claim to the repayment of principal. In this country, however, no debt is perpetual in the sense that it cannot be repaid, since in every case the Government has reserved an option to repay on or after a fixed date upon the terms laid down at the time of the loan issue. Prior to the War almost the whole of the debt was in this form, but since 1914 there has been only one funded issue, the 3½ per cent. Conversion Loan.

65. The Terminable Annuities falling within the deadweight debt are of relatively unimportant size, and consist almost entirely of the liability of the National Debt Commissioners to the public in respect of annuities sold for life and for terms of years. The issue of these annuities is now limited to life annuities which may be paid for in Government stock or in cash. Cash so received is applied to the purchase and cancellation of Government stock, and stock directly transferred is cancelled, the instalments of the annuities set up being charged upon the Consolidated Fund.

66. The unfunded debt consists of those loans which are redeemable at a definite date, with or without an option to repay at an earlier date. It is into this class that the greater part of existing debt falls. That part of the unfunded debt known as the Floating Debt is commonly limited to Treasury Bills and Ways and Means advances, and it is in that sense that we use the term in this Report. It is to be observed, however, that the line between the Floating Debt and other forms of unfunded debt cannot be regarded as rigid, since short-term loans, and even longer-term loans approaching the date of maturity, approximate to the character of Floating Debt.

67. Turning now to the deadweight debt, we find that on the 31st March, 1914 (when the figures were practically the same

as those at the outbreak of war) it amounted to a total of £649,770,000 made up as follows:—

	£	£
Funded Debt:		
2½ per cent. Consols ...	539,428,000	
2¾ per cents.	3,828,000	
2½ per cents.	29,816,000	
Debts to the Banks of England and Ireland ...	13,646,000	
		586,718,000
Terminable Annuities ...		29,552,000
Unfunded Debt:		
Treasury Bills	13,000,000	
Exchequer Bonds ...	20,500,000	
		33,500,000
		£649,770,000

68. After the borrowings of the war period the debt reached its peak at the end of December, 1919. The division on the 31st March, 1920, which does not differ substantially, is shown below, with the comparative figures as on the 31st March, 1926:

	31st March, 1920. £	31st March, 1926. £
Internal Debt:		
Funded Debt	314,952,000	1,073,521,000
Terminable Annuities	19,314,000	12,639,000
Treasury Bills ...	1,058,696,000	564,855,000
Ways and Means Advances	204,887,000	139,441,000
Other Unfunded Debt...	4,955,182,000	4,714,692,000
External Debt	1,278,713,000	1,110,768,000
	£7,831,744,000	£7,615,916,000

The external debt on the 31st March, 1920, included Treasury Bills issued as collateral for loans payable abroad to a total of £48,622,000. On the same date the National Debt Commissioners held (until drawn or paid off) Funding Loan and Victory Bonds amounting to £2,965,000, which had been tendered in payment of death duties; the corresponding figure on 31st March, 1926, was £57,271,000.

The increase in the face value of the debt during the war and immediate post-war periods (regarding the Victory Bonds and Funding Loan referred to above as redeemed) was thus £7,179 millions, and the reduction since effected amounts to £270 millions.

69. The total interest charge in 1925-26, which was naturally on a somewhat larger body of debt than was outstanding at the end of the year, and which includes interest on the Funding Loan and Victory Bonds held by the National Debt Commissioners, was practically £307 millions divided as shown below. The comparative figures for 1919-20 are also given :—

	1919-20.	1925-26.
	£	£
Interest on Funded Debt ...	7,900,000	33,199,000
Interest included in Terminable Annuities	557,000	402,000
Interest on Treasury Bills ...	44,810,000	25,291,000
Interest on Ways and Means Advances	12,398,000	1,881,000
Interest on other Unfunded Debt	218,115,000	212,882,000
Interest on External Debt ...	38,745,000	33,340,000
	*£322,525,000	*£306,995,000

70. In the comparison of both the capital figures and the interest charge, account has to be taken of the manner in which the issues of National Savings Certificates are treated. In the capital account these figure at their issue price only. Budget provision for interest is made only to the extent to which it is anticipated that interest will actually fall to be paid in the year on certificates presented for repayment. A note in the Finance Accounts shows, however, the approximate liability for interest accumulated but unpaid; on the 31st March, 1926, this was estimated at £100 millions (*cf. para.* 998).

It should also be noted that National War Bonds, which are repayable at a small premium varying with the life of the bonds, are included in the debt accounts at par.

THE EXTERNAL DEBT.

(I) FEATURES DISTINGUISHING EXTERNAL FROM INTERNAL DEBT.

(II) PRESENT POSITION OF THE EXTERNAL DEBT.

(1) *Features distinguishing external from internal debt.*

71. It will be most convenient in the first place to deal with the external debt, which, as will be seen from the table given above, now amounts to £1,111 millions. External debt differs in important respects from internal debt of whatever description, and it is desirable to draw the distinction at once as clearly as we can. Most of our witnesses who discussed the matter pointed to the contrast between the internal debt, as involving a mere transfer of purchasing power within the community, and the external debt, as involving a transfer of goods and services to other countries. The contrast is justified.

* These two years are unsuitable for detailed comparison as the 1919-20 figures include only half a year's interest on the debt to the United States Government, and as debt was still increasing in that year. *Cf.*, however, para. 182, *et seq.*

The service and redemption of the external debt are decidedly more onerous in nature in themselves, to the country taken as a whole, than the service and redemption of the internal debt. So much is clear. There is, however, a danger in isolating the present yearly transfer of income and losing sight of the war background. It may lead to the idea that heavy internal borrowing does not very much matter, since it leaves behind no real burden. We propose, then, in the following paragraphs to analyse briefly the two forms of borrowing, and to draw some comparison between them.

72. If a loan is incurred by a country for industrial development, the expenditure will set up a fund for paying the interest and repaying the capital. If the fund is adequate (or, in other words, if the profits of the enterprise are good enough), there will be no real burden, whoever the creditor may be. No general rule can be laid down to decide whether internal or external borrowing is to be preferred. The balance of advantage will depend on the economic situation of the countries concerned. Thus, for a young or expanding country, possessed of large undeveloped natural resources, it may be essential to borrow abroad, if its progress is not to be impeded.

73. When a Government borrows money for war, the expenditure is, in an economic sense, unproductive. That is to say, it does not in general add to the productive capital of the country; it does not create any fund of new wealth out of which the debt obligations can be met. Internal and external borrowing act here in different ways. The root difference lies in the fact that the former, like taxation, involves an immediate using up of the country's own resources, while the latter draws upon the resources of the foreign lender.

74. The War, except so far as the money for it was raised abroad, had clearly to be paid for immediately, and the burden on the community as a whole could not be thrown on to future generations. There was a drain on the national wealth at the time, resulting in actual or economic damage, except so far as the money raised in taxes or loans was provided by extra saving or industrial effort. The main heads under which the damage may be classified are the loss of foreign securities, the using up of potential capital which would normally have flowed into productive industry, the depletion of existing capital, and the depreciation of assets not employed for war purposes.

75. The loss to the nation was, of course, due to the expenditure, and not to the particular method of financing it. The burden of expenditure was incurred once and for all by the nation as a whole; so far as it was met by taxation, it was immediately shared out between individual citizens; so far as it was met by internal War Loans, the tax burden on the individual was postponed, the subscriber receiving a claim to future goods and services in exchange for his money—a claim

which could only be met by future taxation on himself and his fellow citizens. The loans entailed a subsequent annual transfer of wealth within the community for payment of interest and repayment of capital. This transfer, which is the burden to be attributed to the internal debt itself—as distinct from the war expenditure behind it—does not destroy wealth : it merely re-distributes wealth (with undoubtedly important effects) within the community.

76. While the internal debt is owed by the nation to some of its citizens, the external debt is owed by the nation as a whole to other countries, now in the main to the United States of America. The external debt did not, at the time when it was contracted, exhaust any of this country's wealth; instead, the lending countries transferred to us part of their wealth, and we gave them in return a claim on our subsequent production. In consequence, our wealth is now being consumed year by year in payment of interest and Sinking Fund, the payment taking the form of an export of goods and services which do not pay for any imports in return.

77. This is obviously a real and heavy burden to the country as a whole, and is directly attributable to the external debt; it is in quite a different category from the transfer within the country which the internal debt necessitates. The difference must, however, be traced to the fact that the war expenditure associated with the external debt laid no burden upon us, as that associated with the internal debt did. In the one case we were using goods and services lent to us by other countries —resources which were of the utmost value in enabling us to finance the War; the transactions did not hurt us at the time, but the debt had afterwards to be repaid. In the other case we were spending our own wealth, and as a community were suffering at once, although the apportionment of the burden amongst individuals is still proceeding.

78. We have said that, so far as the War was financed by internal loans, the tax-burden on the individual was postponed. We do not forget, however, that part of the borrowing involved inflation which, as is well-known, operates as a kind of covert tax, with features far worse than those of any avowed tax in our system. The inflationary " tax " is not adjusted in any way to the amount of the individual's fortune, and, as between fortunes of the same amount, it benefits one class and hurts another, imposing a heavy burden on people with fixed incomes.

79. We may now notice two disadvantages of the external debt. A toll on production, whether by taxation or by borrowing, is more easily met if, under the special impulse of war, all industry is in full swing, than afterwards in the difficult period of reconstruction, when workers who have been engaged in war service are being painfully re-absorbed into the industries of peace, and when international trade is hampered

by unstable currencies, multiplication of tariffs and disorganised markets. It may reasonably be hoped that the incubus of the external debt will be lightened when trade improves, although this must depend on many factors. At the same time the trade-cycle must be expected to bring with it periods of depression such as were not experienced during the intensive demand created by the War. Thus the burden of war expenditure financed by home borrowing fell upon production at a time when production was stimulated to great activity. The external debt falls upon it year in, year out, the good years having to be taken with the bad.

80. Secondly, the loss to our national production due to the external debt, cannot be estimated until the whole of that debt has been paid off. Goods were in effect lent to us by America at a time when the purchasing power of the gold dollar (in terms of which the debt is fixed) was much depreciated. The loss to our production depends on the value of gold year by year as our payments are made. Other things being equal, the burden to the nation as a whole, and not merely to individual taxpayers, will be accentuated or relieved, according as the purchasing power of gold over British labour and capital increases or diminishes. But an alleviation of the burden due to the value of gold suddenly falling back to something like the level at which the debt was incurred would be very dearly purchased, for it would mean rapid inflation with all its attendant evil. A sudden fall in the value of gold is, therefore, not to be desired, although a slow diminution might be beneficial. The nation must face the prospect of repaying the debt by goods and services considerably in excess, according to any commercial standard, of those which were received. On the other hand, the 3-3½ per cent. basis on which the debt has been funded must, if it is throughout less than the commercial rate, be regarded as a set-off.

81. We have spoken advisedly of the purchasing power of gold over "British labour and capital." As Professor Pigou pointed out to us, the common way of assessing the burden of the debt according to the value of gold in British goods is not strictly accurate. "If a given quantity of our labour and capital comes for any reason to be worth less gold than before, that means, of course, that the real burden of the debt, which is a fixed sum of gold, is increased. But it would not be correct to say that, if the value of the things produced by Englishmen becomes less relatively to gold, therefore, necessarily, the burden increases, because the value of those things may become less relatively to gold owing to labour and capital becoming more efficient. In those circumstances the labour and capital would buy as much gold as before, but a greater quantity of goods" (Q. 552). As regards the immediate future it may be accurate enough, as it is certainly convenient, to contrast gold with goods rather than with their less immediate source. But, on a long view, Professor Pigou's distinction is of practical value.

82. We are not attempting to indicate our views as to the future course of gold prices. We have three reasons for refraining : in the first place, we have not been asked as a Committee to examine the special questions of banking policy with which the future of gold is deeply implicated : in the second place, the future of gold is beyond the region of reasonably safe prediction, if only because, in consequence of the War, so much of the existing gold stock of the world is now concentrated in one country, the United States : in the third place, in the very act of pointing to the uncertainty of the future price of gold, we are indicating one of the serious disadvantages of the external debt, and that, at the moment, is our main purpose.

83. We may notice one further point which has been referred to by some of our witnesses. Payments of interest to British residents on internal loans are subject to Income Tax, while interest on external loans is exempt. This difference appears, on the face of it, to constitute a clear advantage in favour of the internal loan. In reality, however, it only does so to a very limited extent. It is true that, when a loan is raised at home, a new source of taxable income is created. But, so far as the money put into War Loans consists of savings which would equally have been made if there had been no loan and would have gone into industrial, &c., investments, a new source of income would have been created in any case.

84. When a loan is raised in a foreign country, no new source of taxable income is created, but on the other hand there is no interference with the investment of this country's savings in other directions. Consequently, so far as Income Tax goes, there is no plain difference, from the point of view of the State's advantage, between an internal debt at 5 per cent. subscribed out of savings and an external debt at 5 per cent. free of tax.

85. When, however, the flotation of internal loans calls into being savings which would otherwise not have been made at all, the power to tax the interest is a real point in its favour. Such extra savings, may be induced by, e.g., appeal to the patriotic motive, or an offer of specially favourable terms. Again they may be obtained by inflation. In these cases there is no diversion of funds that would normally have gone into industry; there is the creation of an additional, not merely a substituted, source of taxable income. To borrow abroad clearly does not bring into being any addition to the taxable income; to a certain extent then it may involve a heavier burden on the community. At the same time, in so far as the internal loan is financed by inflation, the tax advantage will last only so long as the inflation is not wiped out by subsequent deflation—procured through real savings extracted from the people by taxation or otherwise—and, in general, therefore, it can only be regarded as a temporary advantage.

86. We are, of course, aware that the expediency of raising a debt abroad may rest on something quite different from any comparison of immediate measurable costs. It may, for instance, be preferred on the widest grounds as an alternative to inflation, or again it may be the only method of financing the purchase abroad of essential goods.

(II) *Present position of the external debt.*

87. Of the total external debt as at the 31st March, 1926—£1,111 millions—£136 millions consisted of loans made to this country by certain Allied Governments. The debt settlement concluded for the repayment of the Italian debt to this country, provided for the contra repayment to Italy of £22,200,000 (included in the above figure of £136 millions) by instalments commencing in 1928. The provisional debt agreement for the settlement of France's debt to this country leaves the sum of £53,500,000 as a non interest bearing debt of France to Great Britain, the repayment of which will be settled by a further agreement, the British Government meanwhile retaining the corresponding amount of gold which is included in the £136 millions of loans made by allies. The balance of £60 millions represents loans from Russia and may be regarded as available for set off against the debt owing by that Government to this country.

88. Of the remaining £975 millions, the debt to the United States Government accounts for £931 millions. The balance of £44 millions comprises :—

	£
Central Argentine Railway Company (due in 1926-27)	3,082,000
5½ per cent. Straits Settlements Dollar Loan (due in 1928-29)	3,341,000
5½ per cent. 10 years Dollar Bonds (due in 1929-30)	4,001,000
5 per cent. Straits Settlements Dollar Loan (due in 1929-30)	4,315,000
5½ per cent. 20 year Dollar Bonds (due in 1936-37)	29,504,000
Anglo-French Loan 4½ per cent. Bonds (due in 1940-41)	3,000

89. The great bulk of the external debt—the debt due to the United States Government—is now in the form of a terminable annuity under the agreement concluded in 1923. The repayment of principal is to be made by instalments which commenced on the 15th December, 1923, at $23,000,000 and continue until the 15th December, 1984, with a payment on that date of $175,000,000. The scale of increase of principal repayments is irregular but may be illustrated by the following examples :—1927—$25,000,000; 1933 to 1936—$32,000,000;

1944 to 1946—$46,000,000; 1954 to 1956—$64,000,000; 1963—$83,000,000; 1973—$123,000,000; 1980—$156,000,000. Interest on the bonds outstanding is payable half-yearly at the rate of 3 per cent until 15th December, 1932, and at 3½ per cent. thereafter. Interest and repayment together represent, at par of exchange, approximately £33,000,000 a year for the first 10 years (i.e., until the higher rate of interest takes effect) and thereafter approximately £38,000,000 per annum.

90. It is not necessary for our purposes to review the many loans raised abroad during the War and since repaid. In the main these loans were required to finance the purchase of foodstuffs and war material in the countries concerned, and with few exceptions were in short-dated form. The total outstanding on the 31st March, 1919, was £1,365 millions, which was reduced to £1,278 millions at the end of the following year, mainly by setting off a part of the indebtedness to Canada against sums due to this country. Since then the net reduction in the external debt has amounted to £168 millions, but this figure represents less than the total gross repayments made, since in the same period the debt was substantially added to by the capitalisation of accrued interest on the debt to the United States Government under the repayment agreement, and by minor adjustments of other debts.

91. In the year 1925-26 the actual interest charge in respect of external debt was just over £33 millions or about one-ninth of the total issues for interest in that year. In addition, capital repayments to the United States Government required the issue of practically £5 millions.

92. The problems involved in the repayment of the external loans raised during the War have been greatly eased by the energetic measures taken immediately after the War to deal with the position. In the result some £262 millions (gross) of debt due to various countries has been redeemed by cash payment since 1st April, 1920. Apart from the annual payments to the United States Government, the items remaining are comparatively small, and their redemption should not occasion any great difficulty. The 10-year Dollar Bonds, it may be noted, are convertible into National War Bonds, an option freely exercised in recent years. Whether or not it may be practicable or desirable to take advantage of the option to accelerate repayment to the United States Government it is too early yet to foresee. There is obviously a limit to the amount which can be transferred abroad without damaging effects on industry in this country, and an increase in the present annual burden is hardly to be contemplated until trade conditions improve.

THE INTERNAL DEBT.

93. The full nature of the burden involved in the payment of interest on, and the repayment of, internal debt will come to light in the course of our Report, as we discuss the effects of taxation.

It is clear there is no money burden upon the community as a whole, and no destruction of purchasing power, but the existence of the debt necessitates the levying of higher rates of taxation than would otherwise be necessary, a process which must have economic consequences, while the transfer of resources must influence the extent of savings and the distribution of wealth. These effects we examine in some detail in later sections of our Report (*cf. especially para.* 260 *et seq.*).

94. The extent of the internal transfer for interest and its relation to the Budget receipts of the year (in which Post Office receipts in excess of expenditure are substituted for the gross receipts) are shown in the following table :—

Year.	Budget Receipts.	Internal Debt Interest.	Percentage of col. 2 to col. 1.
	(£ thousands.)	(£ thousands.)	%
1913–14	173,636	16,728	9·63
1919–20	1,295,421	283,780	21·90
1920–21	1,376,485	308,664	22·42
1921–22	1,068,480	285,562	26·73
1922–23	864,155	265,671	30·43
1923–24	787,358	269,914	34·28
1924–25	749,056	272,777	35·08
1925–26	758,112	273,655	36·42

We turn now to a brief examination of the growth of the internal debt during the war period, and the subsequent reductions made, taking first the Floating Debt.

FLOATING DEBT.

95. The extent to which the Government had recourse during the war period to borrowing on Treasury Bills and by Ways and Means Advances is shown in the following table of the amounts outstanding at various dates, including Bills issued as collateral for external loans.

——	Treasury Bills.	Ways and Means Advances.	Total.
	(£ thousands.)	(£ thousands.)	(£ thousands.)
31st March, 1916 ...	566,826	19,896	586,722
" 1917 ...	463,705	217,526	681,231
" 1918 ...	973,444	192,271	1,165,715
" 1919 ...	957,236	454,992	1,412,228
30th June, 1919 (peak)	796,000	774,000	1,570,000
31st March, 1920 ...	1,107.318	204,887	1,312,205
" 1921 ...	1,120,841	154,489	1,275,330
" 1922 ...	877,214	147,301	1,024,515
" 1923 ...	616,010	193,897	809.907
" 1924 ...	588,320	186,155	774,475
" 1925 ...	575,610	166,585	742,195
" 1926 ...	564,855	139,441	704,296

96. The part played by borrowings from the Bank of England on the security of Ways and Means in increasing the volume of purchasing power and the level of prices is well-known, and was fully examined by the Committee on Currency and Foreign Exchanges after the War. In accordance with the policy advocated by that Committee, borrowings in this form from the Bank of England are now limited to such sums as are required to meet purely temporary necessities in anticipation of revenue receipts or permanent borrowings. The amounts shown as outstanding on the 31st March, 1926, consisted entirely of borrowings from Government Departments, which are in the nature of a book-keeping transaction only.

97. Of the Treasury Bills in issue, a proportion is also held by Government Departments or on account of Government Funds. Sir Otto Niemeyer, giving evidence in November, 1925, thought that the amount so held was in the neighbourhood of £150 millions (Q. 8704), a figure which would tend to be reduced as certain war transactions were cleared up, but which depended largely upon the circulation of Currency Notes (Q. 8713). The amount of bills held by the public at that time may, therefore, be put at about £400 to £450 millions, but no definite information is available regarding the distribution of the holdings.

98. With few exceptions, the witnesses who dealt with the Floating Debt position have not considered the present amount as in any way dangerous, and have not, therefore, seen any need for special measures for its reduction. Considerable emphasis has been laid upon the comparative cheapness to the Government of this form of borrowing. Mr. Keynes, in particular, considered that the criterion of the amount of debt to be held in a short-dated form should be provided by the appetite of the investment market for that type of security and that it would be sound policy to maintain the short-dated debt permanently at a high figure, if that high figure could be kept afloat at a rate of interest lower (on the average) than the rate on long-term debt. In his view, the idea that there was something unsafe in maintaining the short-term debt permanently at a high figure was based on false analogy with the case of a private individual or of a company. (*Ev. p.* 277, *E. in C.* : 2).

99. Lord Bradbury expressed the view that the Floating Debt was not at the present moment an active agent of financial or economic mischief, and that, so long as the public and the banks continued to treat it as " investment," it differed little in its nature or in its effects from a long-dated Government stock with a variable rate of interest. He indicated, however, that that variable rate might impose heavy burdens on the Exchequer at inconvenient moments, and there was a danger that this inconvenience might deflect the judgment of the Treasury in times of crisis. There were also potential dangers in that the habit might grow up of using Treasury Bills as currency, and the

liquid character of the Bills might tend to relax the banks' conventional standard of " cash " reserves. In view of these dangers—which, he added, were remote at the moment, but might become real in certain circumstances—Lord Bradbury suggested the use of a proportion of Sinking Fund moneys to reduce the Floating Debt, and the funding of a large part of the remainder after the outstanding short-date bonds had been dealt with. He did not attach much importance to the consideration that the existence of a large Floating Debt was a convenience—and probably a source of considerable profit—to the London money market; if its reduction was desirable in the general interests of the community, the money market must adapt itself to getting on without it (*E. in C.* : 7).

100. As a whole, the evidence given before us does not suggest tnat the present volume of Floating Debt is dangerous in normal times. At the most, as urged by Dr. Dalton, the present volume of Treasury Bills and the constant problem of renewing them are a frequent source of uncertainty to the Treasury and of disturbance to the money market and the Bank of England, which is always liable to be faced with a demand at short notice for Ways and Means advances. (*Ev., p.* 394, *E. in C.* : 5). On the latter point we were informed that the Treasury had not within the last three years been driven to borrow from the Bank because of a failure to renew Treasury Bills (Q. 8712). At the same time, it is clear that the constant need for renewal has certain drawbacks. As Sir Otto Niemeyer pointed out, the State is in the hands of the holders of Bills, who have a purely one-sided option to renew or not : if it is not convenient to those holders to renew, the Treasury has either to take a lower price, having reactions all round on the rate of interest, or adopt the alternative of borrowing on Ways and Means (Q.8689). In the second place, the heavy variations in the rate of interest on a large volume of Floating Debt form an undesirable feature in the Budget.

101. The real dangers of a large Floating Debt would appear in the event of a future national emergency requiring Government borrowing on a considerable scale. In such a case an increase in the Floating Debt would be almost certain to occur, because expenditure naturally precedes any measure taken to increase taxation, or even to raise permanent loans. The fact that a large Floating Debt already existed would make it far more difficult to secure further short borrowings without recourse to measures which would involve serious inflation with all its harmful consequences. It has also to be borne in mind that the tendering for Treasury Bills is affected by the volume of foreign deposits in London, and that a certain quantity of Bills is held by people outside the country (cf., Q. 8690). To some extent, therefore, the renewal of Bills may be affected by any event, either in this country or abroad, which leads to the withdrawal of balances from London. Instances are not lacking of

such withdrawals in circumstances which were in no way due to any change in the financial soundness of this country.

102. In our view, these considerations, whilst not calling for any very rapid reduction of the Floating Debt, do indicate the desirability of a steady gradual reduction. We do not think it possible, at the present time, to fix any limit to which that reduction should proceed. Nor do we think any rule of thumb method of assessing the amount is of value; it must in the last resort be determined largely in the light of the convenience to the Treasury, in its debt and revenue operations, of having a readily variable volume of debt.

103. In reaching our conclusion that the reduction of Floating Debt should be gradual, we have given due weight to the views expressed upon the effect of sudden reductions on the mechanism of the money market. Mr. R. H. Brand pointed out that before the War the banks kept a part of their liquid assets in the form either of short-dated bills or of loans to the discount market secured on commercial bills. Since 1914, however, mainly owing to inflation, banking deposits have more or less doubled, while it was doubtful if the supply of commercial bills had yet risen in nominal value to the pre-war level, although, owing to higher prices they would require to be much greater in nominal value to finance the same volume of trade. The existing gap had been filled by the Treasury Bills, and if these were redeemed very rapidly and commercial bills did not as rapidly increase to take their place, the reserves of the money market would be *pro tanto* reduced. While he deemed it desirable that the Floating Debt should be ultimately much diminished, he thought its reduction should be gradual (*E. in C.* : 7).

104. While clearly, as Lord Bradbury suggested, the needs of the money market must not be allowed to override the general interests of the community, we think that these needs should be amongst the factors kept in view in dealing with the Floating Debt. The most desirable development would, as indicated by Sir Otto Niemeyer, be the restoration of the commercial bill both by general revival of trade and by special revival of London as a money market (Q. 8690). A gradual reduction of the Floating Debt would we think tend to encourage, at any rate, the latter revival, by cheapening credit in London (which, so long as it was caused by a short supply of investments for bank funds, would not be inflationary). There might be some danger of deflationary influences developing even from gradual repayment of Bills, but these could undoubtedly be corrected, if necessary, by suitable action on the part of the Central Bank.

On a review of the evidence placed before us, we are, therefore, of the opinion that a gradual but steady reduction should be made in the volume of the Floating Debt, until it reaches proportions which could not, even in extreme circumstances, be a source of grave danger.

THE GROWTH AND SUBSEQUENT REDUCTION OF OTHER UNFUNDED DEBT.

105. We print as Appendix V a table showing the growth and subsequent reduction of the internal debt year by year, distinguishing as far as possible, under the several loans, the debt created in respect of cash subscriptions or redeemed by cash repayments from the alterations due to the many conversion operations. To this table we annex a series of notes setting out the principal features of each issue and the main conversion and repayment operations which have affected individual loans. Fuller details regarding conversion operations subsequent to March, 1920, are contained in paragraphs 129 to 143 of our Report.

106. It will be seen that the first and second years of the War were financed (so far as met out of borrowings) mainly by the issue of 3½ per cent. War Loan, 1925-28, and 4½ per cent. War Loan, 1925-45, and of a considerable volume of Treasury Bills. In the following year issues were mainly in the form of short dated Exchequer Bonds, until the flotation in January, 1917, of the 5 per cent. War Loan, 1929-47, the largest single borrowing operation undertaken during the War. From that time until after the Armistice the great bulk of borrowings took place by the issue of short-dated National War Bonds, supplemented by further creations of Floating Debt. In June, 1919, the final big loans raised to meet expenditure were launched in the form of the 4 per cent. Funding Loan, 1960-90, and the 4 per cent. Victory Bonds redeemable by annual drawings calculated to repay the debt by 1976. Throughout the period from 1916 onwards considerable sums were also raised by the sale of War (now National) Savings Certificates.

107. As the result of the borrowings for the purposes of the War, the Treasury was faced on the 31st March, 1920, with a total nominal debt of £7,831,744,000, consisting very largely of Floating Debt and of loans of comparatively short life. A table in Appendix V shows the dates of maturity of the internal debt as it then stood. With the exception of the 3½ per cent. War Loan, all loans falling due in years up to and including 1928-29 were in the form of Exchequer Bonds and National War Bonds. The table shows that the face value of the debt to be dealt with in that period was £1,842 millions; in addition small premiums were payable on the maturity of the National War Bonds. As regards the external debt, a decision had already been taken to repay in the year 1920-21 the Anglo-French loan of £51 millions; various other short-dated loans were also due for repayment within the next few years. The Floating Debt amounted to £1,312 millions, of which £1,107 millions were in the form of Treasury Bills. Savings Certificates, the repayment of which could be called for upon demand, represented at issue price a further £274 millions.

108. The magnitude of the maturities and debt at call thus offered a very formidable problem, and the Floating Debt formed a considerable obstacle in the way of reducing the general level of interest upon Government borrowings. The situation was eased only by the fact that the very large amounts of National War Bonds carried the right to convert into the 5 per cent. War Loan, 1929-47, a right which was likely to be freely exercised, given the creation of favourable conditions.

109. We propose now to trace shortly the steps which were taken to deal with the position. For this purpose we will divide our analysis under the heads of (*a*) the provision of money out of revenue for debt reduction; (*b*) the flotation of new loans other than for direct conversions, and (*c*) conversion operations.

Budgetary provision for debt reduction.

110. It has already been mentioned that the nominal amount of the debt reached its peak in December, 1919, the Budget for the year 1919-20 showing an excess of expenditure over revenue of about £326 millions. The following year saw the commencement of the period of debt reduction out of revenue, the Budget being estimated to yield a surplus of £234 millions available for debt repayment, in addition to the provision in the Budget expenditure of £3,840,000 to meet the Sinking Funds attached to Victory Bonds and Funding Loan. The actual issues for debt redemption met out of the revenue of the year 1920-21 exceeded the estimate, reaching the total of £251,823,000.

111. The policy of providing a substantial surplus was continued in 1921-22. The provision for debt charges included £23,500,000 in respect of various Sinking Funds and the estimated surplus of revenue was £84 millions. After taking into account certain additional liabilities likely to rank against this surplus, it was estimated in the Budget statement that some £103,500,000 in all would be available for debt reduction. The realised surplus for the year was, however, considerably below the amount anticipated, reaching only £45,693,000. Adding to this figure the issues for Sinking Funds charged against expenditure, a total sum of £70,704,000 was made available from revenue for debt reduction in 1921-22.

112. In the Budget statement for the following year an alteration of policy was announced. With the exception of the small sum required to meet the capital portion of terminable annuities, no provision was made to reduce the debt, and remissions of taxation reduced the estimated surplus revenue to the small sum of £706,000. On the other hand, it has to be noted that the payment of interest in this year on the debt due to the United States of America represented an increased charge over the previous year of more than £20 millions. It was announced that the various statutory Sinking Funds (excepting, of course,

the New Sinking Fund, which was suspended) would be met out of re-borrowings. In the result the out-turn of the Budget rendered this expedient unnecessary. A small surplus of revenue over the estimate and a large fall in expenditure resulted in a surplus of £101,516,000, after charging against the revenue £24,711,000 in respect of Sinking Fund issues. The total applied out of revenue to the reduction of debt in 1922-23 was thus £126,227,000.

113. In the Budget statement for 1923-24 proposals were made for the establishment of a Sinking Fund of £40 millions increasing in the following year to £45 millions, and to £50 millions as a maximum thereafter; this arrangement was adopted by Parliament under the title of the New Sinking Fund (1923). Emphasis was laid upon the fact that the provision of these sums was not for the most part optional, but was necessitated to a great extent by the contracts entered into with the holders of various loans. While such charges might be met by borrowing once, to suggest that course in two successive years would, the Chancellor indicated, be a serious blow to our credit. The New Sinking Fund (1923) thus set up was inclusive of all statutory Sinking Funds and the capital portion of terminable annuities. As the realised surplus for the year was £48,329,000 (against an estimate of £1,884,000) the total amount available for debt reduction was, including the New Sinking Fund, £88,329,000.

114. In the year 1924-25 the Sinking Fund provision was duly increased to £45 millions. An estimated surplus of £4,024,000 was resolved into an actual surplus of £3,659,000, the total applied to debt repayment being thus £48,659,000.

115. The Budget for 1925-26 provided the maximum of £50 millions for the New Sinking Fund (1923) and estimated for a surplus of £1,660,000. Through the payment of the Coal Subsidy of £19 millions in that year there was actually a deficit of revenue of £14,038,000; since the whole Sinking Fund provision of £50 millions had been issued, the effect was that a net sum of £35,962,000 was applied to debt reduction out of the revenue of the year.

Other receipts applicable to debt reduction.

116. In addition to the issues from the revenue of the year various repayments of a capital nature which are received into the Exchequer, but which do not constitute revenue, automatically go to the reduction of debt, since, by swelling the Exchequer balance, they make it possible to reduce the volume of short-period borrowings. Amongst sums so applied during the years 1920-21 to 1925-26 appear, for example, the amounts repaid to the Exchequer upon the reduction of the size of the Civil Contingencies Fund, and capital repayments in respect of loans for

Land Settlement originally advanced from the Consolidated Fund. While the total repayments available for debt reduction during the period reached the sum of £70 millions, it has to be remembered that in the main this figure is the result of special non-recurrent transactions. In the normal course, such repayments are a negligible quantity.

117. Certain minor receipts which do not pass through the Exchequer, and which are in the nature of composition for annual taxes, are under Statute applicable to debt repayment. Of these the chief are receipts by the National Debt Commissioners for Land Tax redemption and for the composition for Stamp Duty. To those Commissioners are also paid for debt reduction, under the terms of a Treasury Minute, the capital repayments in respect of loans advanced during the War to the Dominions and Colonies, the outstanding capital of which was on the 31st March, 1926, £128 millions. A minor item is that of Donations and Bequests for the reduction of the debt. During the period 1920-21 to 1925-26 the total sum available in the hands of the National Debt Commissioners from these and similar sources was rather more than £16 millions.

118. Apart, therefore, from repayments of debt made out of fresh borrowings, we find that the deadweight debt has been reduced since the beginning of 1920-21 by the application of the following amounts of cash, except in so far as small balances may have been carried over in the hands of the National Debt Commissioners at the beginning and end of the period :—

Year.	Amount issued out of revenue.	Applied out of repayments and out of Exchequer Balance.	Miscellaneous Receipts applied by National Debt Commissioners.	Total.
	(£ thousands).	(£ thousands).	(£ thousands).	(£ thousands).
1920–21	251,823	17,865	1,330	271,018
1921–22	70,704	17,896	838	89,438
1922–23	126,227	12,307	2,182	140,716
1923–24	88,329	594	2,915	91,838
1924–25	48,659	5,796	6,104	60,559
1925–26	35,962*	15,726	3,051	54,739
	621,704	70,184	16,420	708,308

* The actual issue was £50 millions, but the net figure after deduction of the deficit of revenue is shown here.

119. It is not possible throughout to set against these cash issues the particular items of debt redeemed. In the case of the New Sinking Fund the issues are largely associated with particular stocks, the free balance being applied by the National Debt Commissioners in debt redemption generally. The debt

redeemed by these issues and by the miscellaneous receipts applied by the National Debt Commissioners can therefore be identified. But surplus revenue is now, as a matter of financial convenience, applied during the year in which it accrues, and not issued as formerly at the end of the year in the form of the Old Sinking Fund. The revenue, reborrowings, and other receipts all merge in the Exchequer balance which is used for financing all Exchequer payments, whether to meet current expenditure or maturing debt. It is only at the end of the financial year that the surplus revenue can be ascertained, and since the debt transactions have proceeded throughout the year, it is not possible to identify with that surplus (except on a purely arbitrary basis) the items which it has been used to repay. In these circumstances we propose to examine next the main post-war reborrowing and redemption operations, leaving it to a later stage to summarise the sources from which the redemptions were met.

Reborrowings and Repayment of Debt since 1st April, 1920.

120. Appendix V, which gives the debt transactions from 1914-15 to 1925-26, shows in detail the reborrowing operations undertaken from 1920-21 onwards and the repayments which were made out of the cash so raised and out of other moneys available for debt reduction. We need only briefly refer to certain of the principal transactions.

121. In 1920-21 only minor internal borrowing operations were undertaken, of which the chief was the issue of 10-year Treasury Bonds bearing a rate of interest of 5 per cent., subject to increase to 7 per cent., if the average rate of discount on Treasury Bills issued to the public in the preceding half-year was 6½ per cent. or over, or to 6 per cent., if that average rate was over 5½ per cent. and under 6½ per cent. The total issue of these bonds in the year reached just over £23 millions. National Savings Certificates were issued to the extent of £41 millions and the volume of Treasury Bills (internal) was increased by about £30 millions. External borrowings amounted to £40 millions.

122. The repayments of debt in the year were therefore in the main met out of the revenue issues of £252 millions. External debt was reduced by £145 millions (including £16 millions of Treasury Bills) and internal redemptions as detailed in Appendix V amounted to £230 millions. Of this sum the actual maturities were only £29 millions of 5 per cent. and 6 per cent. Exchequer Bonds. Ways and Means advances were reduced by £50 millions and Savings Certificates were encashed to the extent of £30 millions.

123. In the year 1921-22 various issues of short-dated Treasury Bonds were made for cash to an aggregate amount of about £339 millions, and issues of Savings Certificates realised the exceptional sum of £93 millions, owing to the heavy subscriptions made prior to an imminent change in the terms of issue. These issues enabled a great improvement to be effected in the Floating Debt position, the internal Treasury Bills outstanding being reduced by some £215 millions, and Ways and Means advances by £7 millions. External debt redeemed totalled £64 millions (including £28 millions Treasury Bills), and internal loans redeemed or purchased for cancellation aggregated £160 millions. The actual maturities included in this sum were £19 millions of 5 per cent. Exchequer Bonds (the balance being converted into 5½ per cent. Treasury Bonds) and £32 millions of 5¾ per cent. Exchequer Bonds, 1925, in respect of which the holders had exercised their right to call for repayment in this year. Savings Certificates encashed totalled £36 millions.

124. In 1922-23 further Treasury Bonds were issued for cash to a total of £158 millions, and Savings Certificates realised £40 millions. Of the large block of National War Bonds falling due in this year, all but £44 millions were converted into 5 per cent. and 4 per cent. War Loan under the option given in the original prospectus. This balance was repaid in cash, together with a balance of £21 millions of maturing Exchequer Bonds, the holders of which did not accept an offer to convert into 3½ per cent. Conversion Loan. The volume of internal Treasury Bills was again largely reduced, £258 millions being repaid, but Ways and Means advances increased by £46 millions. External debt was redeemed to the extent of £24 millions (including about £4 millions Treasury Bills) and other internal redemptions amounted to £51 millions, including £28 millions of Savings Certificates.

125. Only small issues of Treasury Bonds were made for cash in 1923-24, about £35 millions being created, while some £45 millions was raised by the issue of Savings Certificates. As the result of conversion offers into War Loan, 3½ per cent. Conversion Loan and Treasury Bonds, only £52 millions of the National War Bonds due in the year remained to be paid in cash. Other internal redemptions totalled £96 millions (including Treasury Bills, £28 millions; Ways and Means Advances, £8 millions; and Savings Certificates, £33 millions), while external debt was reduced for cash by £20 millions.

126. In 1924-25 the first issue of Funded Debt for cash since before the War was made in the form of 3½ per cent. Conversion Loan. Tenders for this stock were invited subject to a minimum price of 77½ per cent. The amount of stock actually issued was £59,660,000, realising £46,302,989, or an

average price of practically £77 11s. Treasury Bonds to a total of £18 millions and Savings Certificates to a total of £32 millions were also issued. The maturities included 5¾ per cent. Exchequer Bonds to a total of £135 millions, but conversion operations left only £53 millions to be repaid in cash. National War Bonds to be repaid totalled only £6 millions. The Floating Debt was reduced by £32 millions and Savings Certificates encashments amounted to £29 millions. Other internal repayments aggregated £28 millions, and external debt of about £5 millions was redeemed for cash.

127. In the last completed financial year two further issues of 3½ per cent. Conversion Loan were made for cash by tender, realising an average price of £76 17s. for an issue of £30 millions and of £76 6s. for an issue of £40 millions. The cash raised by the total issue of £70 millions stock was £53,688,118. Other sums raised were £35 millions by Savings Certificates and £6 millions by Treasury Bonds. External debt was repaid to the extent of £5 millions. The Floating Debt was reduced by £38 millions, and Savings Certificates repayments were £28 millions. Other internal redemptions totalled £74 millions, including maturities of National War Bonds (£8 millions) and of Treasury Bonds (£24 millions).

128. These borrowings and repayments of debt (which, as already explained, can be traced in detail in Appendix V) may be summarised as follows, it being understood that the repayments were met not only out of fresh borrowings, but out of the revenue available for debt reduction, repayments to the Exchequer, and the miscellaneous items arising in the hands of the National Debt Commissioners (*see para.* 117). A net figure only is included in the table for the Floating Debt reduction.

Year.	Debt created.	Cash raised.	Debt repaid.	Cash applied.
	£	£	£	£
1920-21 ...	104,778,000	112,092,000	345,787,000	364,604,000
1921-22 ...	433,461,000	417,839,000	445,991,000	460,071,000
1922-23 ...	198,392,000	219,621,000	349,975,000	348,636,000
1923-24 ...	83,873,000	81,858,000	167,549,000	166,375,000
1924-25 ...	113,416,000	99,079,000	154,559,000	151,384,000
1925-26 ...	111,541,000	95,248,000	145,808,000	142,058,000
	1,045,461,000	1,025,737,000	1,609,669,000	1,633,128,000

It should be added with reference to this table that the cash figures for individual years do not necessarily correspond exactly to the debt created in the year, owing to the varying dates of receipt of loan instalments, and, in the case of the earlier years, owing to cash adjustments in respect of external debt being in some cases delayed. Over the period, however, there is rough correspondence.

Results of Conversion Operations.

129. We turn now to the alterations in the form and amount of the debt which have taken place as the result of conversion operations. In Appendix VI we publish a table furnished to us by the Treasury showing the changes in the amount of principal and in the interest charge, which have resulted from these operations. The table includes also certain issues for cash, the proceeds of which can be identified as having been used to repay particular maturities; these form a part of the issues and redemptions for cash referred to in the preceding paragraphs.

130. The amount of debt repaid out of these identifiable cash issues (including £65 millions in the last quarter of 1919-20) is given as £307 millions, while the corresponding amount of debt created is almost £334 millions, an increase in the face value of nearly £27 millions. The effect on the interest charge was, however, a saving of £1,232,000 per annum. The increase in face value resulted in the main from the fact that various maturing bonds were met out of part of the proceeds of the 3½ per cent. Conversion Loan issued by tender in February and April, 1925; these operations account for the addition of £22 millions to the debt though there was a saving in the interest charge of £614,000. With the exception of these loans, all the new borrowings shown were of a short term nature redeemable at latest by 1933.

131. The remainder of the table deals with pure conversion operations. Two classes of conversion have, however, to be distinguished, (*a*) conversions in pursuance of options given in the past and (*b*) conversions in response to new offers. The former were given to the subscriber under the prospectuses of the original loans, as an additional incentive to subscribe. In general such an option must be anticipated to be of value to the subscriber rather than to the Government; otherwise it will not fulfil its function of encouraging subscriptions. The greater the improvement in the Government's credit, the greater the value of the option becomes, and consequently the result upon the interest charge when conversion is actually carried out is likely to be unfavourable in comparison with the saving which might have been effected by redemption from reborrowings. The principal options given during the War and exercised during the period to which the table relates were (*a*) to convert 5 per cent. National War Bonds into 5 per cent. War Loan 1929-47 at the rate of £105 5*s*. 3*d*. War Loan for £100 Bonds, and (*b*) to convert 4 per cent. National War Bonds into 4 per cent. War Loan 1929-42 at par. Holders of the 5½ per cent. Gold Dollar Bonds issued in the United States of America were also given an option to convert into National War Bonds at the rate of £232 12*s*. 0*d*. of those bonds for each $1,000 Gold

Bonds surrendered. The result of the exercise of these options from the 1st April, 1920, up to the 31st March, 1926, is shown by the table to be :—

——	From.	To.	Increase in Capital.	Increase in Interest Charge.
	(£ thousands.)			£
5 % National War Bonds ...	306,181	—	—	—
into 5 % War Loan ...	—	322,296	16,115	806,000
4 % National War Bonds ...	13,138	—	—	—
into 4 % War Loan ...	—	13,138	—	—
5½ % Gold Bonds	46,706	—	—	—
into 5 % National War Bonds.	—	52,872	6,166	75,000
	366,025	388.306	22,281	881,000

Against this increase in capital and interest there is, however, some offset, in that 5 per cent. National War Bonds are repayable on maturity at a small premium varying with the life of the bonds. The amount of premiums which would have been payable on the bonds converted is calculated to be about £9,092,000.

132. A further option given under an original prospectus is shown separately, since the original issue fell outside the war period. The holders of 5½ per cent. Treasury Bonds issued in 1921 at 97 per cent. and 98 per cent., and repayable at par in 1929, were given the right to convert in 1922 into 3½ per cent. Conversion Loan at the rate of £146 of that loan for each £100 Bond surrendered. The exercise of this option resulted in the conversion of £214,522,000 bonds into £313,201,000 Conversion Loan, an increase in the face value of £98,679,000, which was accompanied by a decrease of £837,000 a year in the interest charge. In effect this option followed so soon on the original issue as to make it practically one of Conversion Loan at about 67 per cent., or £149 loan for £100.

133. The net result of the options given at the time of issue of the original loans was thus to increase the face value of the debt by £121 millions, and the interest charge by £44,000.

134. It is, however, more material with regard to the future to look at the results of the several offers which have been made to holders of debt at or about the date of maturity. These comprise the balance of the issues shown in the table, with one exception to which we refer later (*para.* 142). In such cases the terms of conversion must, of course, be related to the market conditions of the time; since debt is maturing and must be met, the Government has no option but to effect new borrowings either directly or through a conversion offer, unless provision for repayment from revenue can be made. We take these offers in the order in which they were made.

135. In April, 1921, an offer of 3½ per cent. Conversion Loan was made to holders of National War Bonds maturing at various dates from 1st October, 1922, to 1st September, 1925. For each

£100 of maturing bonds Conversion Loan of an amount varying from £160 to £163 was offered, the higher amount being given in replacement of the shortest-dated bonds. This offer resulted in the replacement of £164,000,000 bonds by £266,000,000 Conversion Loan, an increase in the face value of £102,000,000. The interest charge was also increased by £1,110,000 against which must be taken into account a saving of premiums of £3,381,000, which would ultimately have become payable on the bonds.

136. In conjunction with the issues for cash of 5½ per cent. Treasury Bonds in the latter part of 1921, an offer to convert into these bonds at par, with a small cash payment, was made to holders of certain Exchequer and National War Bonds maturing at dates up to September, 1923. About £90 millions of bonds were converted, the addition to the interest charge being £454,000.

137. In February, 1922, a further offer of 3½ per cent. Conversion Loan was made to holders of Exchequer Bonds maturing in April at the rate of £136 of loan for each £100 bonds and was accepted to the extent of £14½ millions of Exchequer Bonds. Conversion Loan was set up to a total of £19½ millions, an increase in the debt of £5 millions, accompanied, however, by a reduction in the interest charge of £35,000.

138. This was followed in April, 1922, by an offer of 3½ per cent. Conversion Loan to holders of National War Bonds maturing in October, 1922, and April, 1923, who had not accepted conversion in the previous year. In this case, the amount of Conversion Loan issued in exchange for £100 bonds was £134, which compares with £163 offered in April, 1921. Some £70 millions of bonds were converted, increasing the face value of the debt by £24 millions, but reducing the interest charge by £218,000. An alternative proposal in respect of the same bonds resulted in the issue of some £14 millions of 4½ per cent. Treasury Bonds (with a cash payment of £4 per cent.), leading to a small increase on the debt and a reduction in the interest charge of £52,000.

139. In the following year about £11 millions of National War Bonds were converted into 4½ per cent. Treasury Bonds, 1932, without increase in the debt, a cash payment of 2¾ per cent. for each £100 bonds surrendered being made. An interest saving of £57,000 was shown by this operation.

140. In 1924-25 holders of maturing 5¾ per cent. Exchequer Bonds were given the opportunity to exchange into two new issues. The first was 4½ per cent. Conversion Loan repayable at par on the 1st July, 1944, or at the Government's option on or after the 1st July, 1940. No issue of this stock for cash has been made. Conversion was offered at par with a cash payment of 2¼ per cent. to the holders in respect of each £100 bonds converted. The second offer was to exchange the bonds at par for 4½ per cent. Treasury Bonds redeemable in 1934. Exchequer

Bonds to a total of £82 millions were converted without increase in the debt (a cash payment of £1,298,000, however, being made), and with an interest saving of £1,026,000.

141. Summarising the particulars we have given, it will be seen that over the whole period from 1st April, 1920, to 31st March, 1926, the conversion offers made by the Government to holders of maturing securities (in some cases the offer being made appreciably before the actual date of maturity) resulted in the exchange of loans of a face value of £447 millions into new loans aggregating £578 millions. The increase in face value was thus £131 millions; the net result on the annual interest charge was an increase of £176,000. Against this has to be set a saving of premiums which would otherwise have had to be paid on maturing National War Bonds of £6,057,000. On the other hand, the cash payments made to holders accepting conversion of certain securities totalled £5,480,000.

142. One further conversion operation remains to be mentioned —that of a stock which had still some years of life before reaching the date upon which the Government had an option to repay. In April, 1924, holders of 5 per cent. War Loan 1929-47 were, subject to a maximum amount to be converted of £200 millions, given the opportunity of exchanging into 4½ per cent. Conversion Loan 1940-44, at the rate of £103 of that loan for each £100 of 5 per cent. loan surrendered. The actual amount converted under the offer was only £148 millions, in exchange for which Conversion Loan was issued to a total of £153 millions. The effect upon the interest charge was a reduction of £541,000.

143. The results of all the conversion operations referred to above, and shown in the table furnished by the Treasury, may thus be summarised :—

——	Debt cancelled.	Debt set up.	Increase in the debt.	Effect on interest charge.
	(£ millions).			£
Conversion in March Quarter, 1920.	100	100	—	+362,000
Conversion under options in original prospectuses :				
(*a*) issued during the war	366	388	22	+881,000
(*b*) issued after the war...	215	313	98	—837,000
Conversion of maturing debt	447	579	132	+176,000
Conversion of 5% War Loan, 1929—47.	148	153	5	—541,000
	1,276	1,533	257	+ 41,000
Indentifiable reborrowings ...	307	334	27	—1,232,000
	1,583	1,867	284	—1,191,000

The surrender of £546 millions of National War Bonds cancelled a future liability for premiums amounting to £15 millions on which interest at 5 per cent. would have been £750,000 per annum. On the other hand cash payments totalled £5,480,000, on which interest similarly may be reckoned to be £274.000.

Summary of Debt Transactions, 1920-21 to 1925-26.

144. We may now summarise the debt transactions over the whole period from 1st April, 1920, to 31st March, 1926. On the former date the total deadweight debt was £7,831,744,000, and on the latter £7,615,916,000, thus showing a net reduction of £215,828,000. Account must be taken, however, of the Victory Bonds and Funding Loan tendered for death duties in the period and purchased out of the Sinking Fund. These, though not yet cancelled, are an asset held against the debt which may properly be deducted in a comparison over the period. The amount held on the 1st April, 1920, was £2,965,000 as against £57,271,000 on the 31st March, 1926. With this adjustment the total net reduction becomes £270,134,000.

145. We have already shown that, in the same period, the amount which was made available for debt reduction out of revenue, repayments and other receipts was £708,308,000 (*para.* 118). The main reasons which have prevented a commensurate reduction in the debt are the issue of conversion loans (and to a less extent of loans for cash) on terms which involved a large increase in the face value of the debt, and the capitalisation under the agreement of 1923 of arrears of interest on the debt to the United States Government. On the other side a small reduction of debt has been effected without the issue of cash by setting off a part of our debt due to Canada against debt due to this country by that Dominion. Minor variations arise, in the case of repayments of external debt, from the rates of exchange at which the transactions were effected.

146. The tables which we have already given may be gathered together in the following summary which indicates at a glance the total debt created and redeemed by different classes of operations, and the corresponding cash figures :—

	Period, 1st April, 1920, to 31st March, 1926.			
	Debt.	Debt.	Cash.	Cash.
	(£ millions.)			
Debt on 1st April, 1920 ...	7,829	—	—	—
New borrowings for cash (*para.* 128).	1,045	—	1,026	—
Debt redeemed for cash (*para.* 128).	—	1,610	—	1,633
Debt set up in respect of conversions (*para.* 143).	1,433	—	—	—
Debt converted (*para.* 143) ...	—	1,176	—	—
Funding Loans and Victory Bonds purchased and still held (*para.* 144).	—	54	—	47
Other debt created—				
Debt to United States Government, interest capitalisation.	108	—	—	—
Minor adjustments	1	—	—	—
Debt set off with Canada ...	—	18	—	—
Cash available from revenue, etc .(*para.* 118).	—	—	654	—
Debt on 31st March, 1926 ...	—	7,558	—	—
	10,416	10,416	1,680	1,680

147. It will be observed that the cash available as shown in this table is less than the figure in paragraph 118 by £54 millions. This is due mainly to the issue from 1920 to 1922 of one-half of the proceeds of Savings Certificates for investment in Local Loans Stock, under an arrangement for granting loans to Local Authorities up to a proportion of the sales of certificates in the local area. These issues have now ceased; but since the cash raised appears in the figures of borrowings, it falls to be excluded from the table in paragraph 118 in arriving at the sum available for debt reduction. A small difference arises also from balances not yet applied to debt reduction.

148. We may at this point briefly refer to the debts due to this country in respect of loans made to Allies, Dominions, &c., during the War period, and for reconstruction purposes at later dates. The published accounts show that the amount of principal outstanding on the 31st March, 1926, in respect of advances to the Dominions and Colonies was just over £128 millions. The greater part of this sum is repayable by annuities. The interest received is carried to the Exchequer, while the principal repayments are paid over to the National Debt Commissioners for the reduction of debt.

149. As regards debts due from Allies, the accounts show that the aggregate payments due by Italy and Roumania under Funding Agreements total £306 millions. The principal sums remaining outstanding in respect of other funded loans, mainly granted for reconstruction purposes, amount to nearly £24 millions. The unfunded debts stand in the accounts at a total of £1,534 millions, of which advances to Russia account for £794 millions and advances to France for £647 millions. A provisional agreement has been drawn up for the settlement of the latter debt.

150. It is impossible at the present time to form any estimate of the total future receipts in respect of these loans. So far as interest is actually being paid, the proceeds are brought into the revenue under the heading of Receipts from Sundry Loans; capital receipts, where definitely identifiable as such, are, we understand, issued to the National Debt Commissioners for debt reduction. In the case of the annual payments falling due under the funding agreements with Italy and Roumania, which, because of the nature of the settlements, are not allocated as principal and interest, the total receipts are brought to account as revenue. (*See also para.* 999.)

151. While we have thought it desirable for an appreciation of the present position of the debt to review the war and post-war operations at some length in our Report and Appendices, it must be confessed that little positive guidance for the future can be drawn therefrom. In most cases the form of the loan

issues had to be determined in accordance with the circumstances of the moment. The expectation of rising rates of interest during the war period necessitated the floating of definitely redeemable loans throughout, and the attachment of other safeguards against depreciation became necessary in the later stages to attract the large sums which it was essential to obtain. Excluding the 4 per cent. and 5 per cent. War Loans, it is to be noted that, with insignificant exceptions, the whole of the remainder of the internal debt created during the period of hostilities was borrowed on terms which required it to be repaid, or otherwise dealt with, by 1929 at latest.

152. Almost immediately after the end of the War steps were taken to ease the position by the issue of two long-term loans—the Funding Loan and Victory Bonds. In 1920-21 the next step forward was the balancing of the Budget and the provision out of revenue of over £250 millions for debt reduction. From that point it became possible to effect a much-needed reduction in the volume of the Floating Debt. At later stages, a return to the issue of loans in funded form was made, and, although to a considerable extent maturities have been met by the issue of loans of comparatively short life, substantial progress in funding —and in conversion into longer term debt—has already been made.

153. We have no doubt that the improvement in the debt position is largely due to the provision year by year of a substantial sum for debt redemption. At the same time it is, perhaps, the most striking feature in our review of debt operations that the effort made has not produced a greater impression upon the total of the debt. The improvement lies, so far as the capital debt is concerned, perhaps more in a re-arrangement of maturity dates than in the absolute reduction effected; the change in the interest position, which we will examine later, is, however, marked. (*See para.* 182 *et seq.*)

154. We have already mentioned the reasons which have kept up the total of the debt The increase, due to the capitalisation of the interest on the debt to the United States Government was of course inevitable. To some extent also it was to be anticipated that reborrowing and conversion operations on a large scale would lead to some capital increase. The very large addition which has in fact been made through conversions is almost entirely due to the several offers of 3½ per cent. Conversion Loan, which resulted in the creation of £693 millions of this stock in exchange for securities of a face value of £463 millions, and thus involved an inflation in face value of £230 millions. In addition, about £129 millions of Conversion Loan have been issued by tender realising approximately £100 millions. The total inflation in face value resulting from the issue of this particular stock was, therefore, nearly £260 millions.

THE ISSUE OF LOANS AT A HEAVY DISCOUNT.

155. The policy of issuing loans in a form which adds to the capital of the debt was referred to in evidence before us by Professor Cannan, Dr. Hugh Dalton and Professor W. R. Scott. The first-named witness pointed out that whether it was advantageous or not depended on future events—when the debt was to be paid off, and the market rate of interest payable during the period—as well as on the interest annually payable. Even if a balance of advantage could be shown by arithmetic and prophecy, that balance, in his view, needed to be quite considerable in order to outweigh the discouraging psychological effect of the increase of capital. He thought also that a nation was far more likely to provide a large annual sum for debt purposes if the interest was large and the capital small than if the interest was small and the capital large (*E. in C.*; 4).

Dr. Dalton also expressed his opinion that conversions of this nature were open to strong objection; though he did not think the objections so marked in the case of loans redeemable only at the State's option as in the case of loans repayable at a definite date (*Ev.*, p. 394, *E. in C.*; 9). Professor Scott characterised such operations as mere "window-dressing," and thought that, if they had had any beneficial effect, it had been exhausted (*E. in C.*; 33).

156. In view of the importance of this question in relation to future debt operations, we think it desirable to deal with it at some length. *Prima facie*, it appears that the issue of loans at a heavy discount instead of at par can only be justified if that expedient is so acceptable to the investor as to secure to the State advantages in the terms of issue sufficient to counterbalance or outweigh the disadvantages resulting from the increase in the capital of the debt, or if in any circumstances it can be shown to be essential to secure some reduction in the current interest charges in the Budget, even at the expense of an increased capital charge.

157. The second of these conditions applies more particularly to the issue of loans redeemable at a definite date. The device, it might be argued, secures a reduction of the total debt charge without trenching directly on the Sinking Fund provision, and therefore tends to preserve whatever credit attaches to the apparent maintenance of a consistent policy of debt redemption, while at the same time permitting of some relief in taxation. Indirectly, however, the effective operation of any existing Sinking Fund is reduced in very much the same way as though a part of it were provided by new borrowing. To be compatible with a definite policy of debt repayment by means of an annual Sinking Fund, the issue of definitely redeemable loans at a heavy discount must be accompanied by a compensating increase in the amount of the Sinking Fund provided out of annual revenue.

158. The outstanding example of loans issued at a substantial discount in this country is that of the 3½ per cent. Conversion Loan, the sole form of funded debt issued since 1914. In the first place we will consider the policy of such issues by reference to a funded stock of this nature, redeemable only at the Government's option after the expiry of a rather long period; with some qualifications, however, similar considerations apply to loans redeemable at a definite date.

159. The essential question, in considering the comparative advantages of different forms of issue, is whether the investor takes into account and is guided by all the factors which bear on the real value of the issue and which determine its ultimate cost to the State. If he does, the form of issue would be of little account. But in some respects the outlook of the average investor and that of the State would appear to be essentially different. The former is in the main concerned with the advantages which will materialise within a limited period; whatever ultimate advantages the State may give in loan contracts, the investor's inclination will be to pay for the benefits as he estimates them in the light of his requirements, rather than for those greater or lesser ultimate benefits which in theory, at any rate, he will receive. The State must, on the other hand, take a long view and look carefully ahead at the bearing of its present debt policy on the exercise of such options as it reserves to itself when making loan contracts with its citizens.

160. It seems clear that the case for issuing loans at a heavy discount rests mainly on the assumption that the investor will pay relatively more for such a stock than for one of similar real yield issued at or very near par. If his immediate income were to be the same in both cases, the State obviously loses. The annual interest charge remains unaltered and the prospects of conversion to a lower rate of interest are reduced. The advantages which the investor may expect to receive by taking a stock bearing a low nominal interest are the prospect of capital appreciation and a greater relative immunity from the exercise of the State's option of redemption (or, in effect, conversion) after the date reserved at the time of issue. These prospects naturally presuppose a fall in future rates of interest; on any other supposition the investor would not be attracted by an issue of funded debt but would prefer an issue definitely redeemable at a fixed date.

161. Where a loan is definitely redeemable at a stated price, the investor can, of course, calculate, at whatever interest rate he thinks appropriate, the present value of the known appreciation at the date of redemption. This value, of course, becomes less, the longer the period of the loan. When, however, the prospect is not only distant but uncertain, as in the case of funded debt (since the Government is under no obligation to repay), its value becomes to the individual very small indeed, and

we think that, in practice, the tendency of the average investor is to look almost entirely at the immediate interest return with, perhaps, some vague prospect in his mind of capital appreciation. For this prospect we doubt whether he will be prepared to pay much. Given a very distant option date, appreciation as rates of interest fall probably applies for many years almost as much to a stock issued near par as to one issued at a considerable discount; it is only as the option begins to be a thing of real moment that it affects to any considerable extent the market valuation.

162. It is likely that the main attraction of capital appreciation, as a substitute for immediate income, lies to a large extent in its immunity from income taxation. In the case of Government loans, however, what the individual investor gains in this respect is lost by the State, and, consequently, so far as it enters into the relative attractions of an issue at a discount, it should be taken into account in the terms of issue and increase the relative difference in price required to justify issue at a discount. We doubt whether, in fact, the State is likely to obtain the extra margin required, since the price of the stock will tend to reflect the advantage to that investor who gains least of all from the tax exemption.

163. The principal advantage which the investor secures is, however, a relatively greater immunity from a reduction of the interest on his investment when the Government's option becomes operative. Assuming that interest rates are at that time round about 3½ per cent., in the case of a 4½ per cent. loan issued at about par the State will be enabled to convert to a 3½ per cent. basis and the investor's income will fall correspondingly. If, however, he has instead taken a 3½ per cent. stock at a discount, the State will not be in a position to reduce his income. It will, we think, be generally agreed that, with the expectation of falling rates of interest, an investor will be deterred by an early option of repayment which, as was exemplified before the conversion of Consols in 1889, depresses the price in comparison with other Government securities. But when that option is so remote as 30 or 40 years ahead, it is doubtful whether it is taken into account by the individual. It is significant that the 4 per cent. Funding Loan stands at practically the same relative price as the 3½ per cent. Conversion Loan. The former must, of course, be repaid in 1990, with an option after 1960, but the present value of the premium on repayment is so small that it can make little difference in the market quotation; hence it does not appear that the greater immunity of the Conversion Loan is reflected in its price. On the whole, we are of opinion that a very distant option has little effect on the investor.

164. Looked at from the point of the State, the value of the option of repayment is clear. It will probably be of assistance

to take a concrete example, such as the raising of £100 millions cash, when the yield of Government securities is about 4½ per cent., by the issue of, approximately, (*a*) £130 millions of 3½ per cent. stock at, say, 77, or (*b*) just over £100 millions of 4½ per cent. stock at slightly below par, the Government in both cases reserving the option to redeem, as in the case of Conversion Loan, in 1961.

The greatest gain to the State from the conversion of the 4½ per cent. stock will be secured if the yield of gilt-edged securities has fallen by 1961 to such a point that a conversion to 3½ per cent. (or less) at par is possible. Conversion to 3½ per cent. means a saving of £1,000,000 a year in interest, which, on a 3½ per cent. basis, is worth about £28½ millions in capital. The present value of this capital at 4 per cent. (the mean of the rates assumed at the beginning and end of the period) is about £7,000,000, or the equivalent of 7 per cent. on the amount of the issue. If in 1961 the yield of gilt-edged securities still remains at 4½ per cent., the question of conversion does not arise, but, if yields have fallen at all, there remains the possibility of converting to some rate intermediate between 3½ per cent. and 4½ per cent., with a correspondingly reduced saving of interest.

165. If the alternative of issuing 3½ per cent. stock is adopted, conversion in 1961 only becomes a possibility should the interest rate have fallen below 3½ per cent., a condition which would, it should be noted, also enhance the benefits derived from the conversion of a 4½ per cent. stock. Unless, therefore, the terms secured for an issue of a 3½ per cent. stock are relatively more favourable than those for a 4½ per cent. stock, a definite future loss to the State arises, save in the event of interest rates remaining stationary or rising. It is, of course, impossible to foretell what the future course of interest rates will be, but on the assumption that over a long period (provided there are no very disturbing factors especially near the conversion date) there will be a considerable fall, the Government option to convert must be regarded as very valuable, and it is certainly, we think, equal to three or four points in the issue price; that is, it would be as profitable to issue 4½ per cent. stock at some points below par as to issue 3½ per cent. stock at 77, or alternatively the price of the latter stock should be relatively higher.

166. On consideration of the whole of the points involved, we are of opinion that it is highly improbable that such an addition to the issue price of a 3½ per cent. stock will be secured. It follows that, in our view, the State will in general be in a better position if issues of stock are made at or slightly below par rather than at a heavy discount. We also attach a certain amount of weight to the psychological effect of the increase in the debt which results from the issue of loans at a heavy dis-

count; this in our view outweighs any possible advantage that may result from the introduction on the market of Government loans bearing a low nominal rate of interest.

167. The position in regard to the issue at a large discount of stock not funded but definitely redeemable at a fixed date is somewhat different from that already considered. Here the investor is in a position to take into account the certainty of repayment so many years ahead, instead of merely discounting the chances of conversion. What the State really pays is a reduced annual charge at the expense of an increased capital repayment a certain number of years ahead; and the value of that increased capital repayment is commonly taken into account in the calculation of the real yield which the investor receives. If the investor were content to take his stock at such a price as makes the real yield the same as that ruling generally on gilt-edged securities, irrespective of the type of loan issued, it would seem at first sight that there can be no disadvantage to the State in issuing at a discount, though we think there is some force in Professor Cannan's contention that a nation is more likely to provide a large annual sum for debt purposes if the interest is large and the capital small than if the interest is small and the capital large. An examination of the yields of various securities, however, tends to the conclusion that the investor demands a certain compensation in the interest rate for the postponement of the enjoyment of a full market return on his capital where that postponement applies to an appreciable amount. He, in fact, surrenders for the time being his command over annual spending power, and, in so far as his inclination is to secure the maximum annual income, is deterred from investing in a stock at a large discount.

168. Moreover, as in the case already considered, the State loses a certain amount of income taxation for which it is doubtful whether adequate compensation is received in the price of issue. In a time of falling interest rates the State also takes the risk of accumulating the extra capital for repayment at a lower rate of interest than that commonly assumed by the investor to represent the real return to him, or, alternatively, it may have to repay an increased capital value (and not merely the sum borrowed) at a time when the price level is lower than that at which the money was borrowed and the real burden on the community is therefore correspondingly greater. In issuing a loan at a heavy discount two assumptions tend to be made; first, that interest rates will fall, and second, that the price level will rise, or at any rate not fall, and it is doubtful whether these assumptions in combination have a high degree of compatibility.

169. The factor of the value to the State of future conversion possibilities does not enter into the case now under consideration, unless, in addition to the ultimate redemption date, the

State, as is commonly the case, reserves an option to repay on or after an earlier date. In that event the disadvantages already set out in regard to the issue of funded debt at a low nominal rate of interest may become of equal importance.

170. We are of opinion that it would be in the best interests of the State to issue all future loans at a figure not very appreciably below par. In making this recommendation we have not overlooked the possibility that a change in the policy of issuing 3½ per cent. Conversion Loan for funding operations might conceivably be regarded as damaging to the national credit. It is to be recalled, however, that, while the 3½ per cent. Conversion Loan remains the sole form of funded debt issued since the war, a return to a redeemable stock bearing a higher nominal rate of interest—the 4½ per cent. Conversion Loan 1940-44—was made in connection with conversion operations in 1924-25 and the following year. We do not think that any important reactions would be felt if our recommendation is adopted, the more particularly if a new funded stock were floated in connection with an operation of some magnitude, in order to ensure at once a free market.

SPECIAL TAXATION PRIVILEGES ATTACHED TO LOANS.

171. A further question somewhat allied to that we have just considered is whether the State secures full consideration in respect of special taxation privileges attached to loans. In notes to the tables showing the debt created and redeemed during and since the War (*Appendix* V) we have alluded to the main privileges given in connection with various issues. These are as follows :—

(*a*) Exemption of interest from *liability to assessment to British Income Tax*, other than Super-tax.

(*b*) Payment of interest in full *without deduction of Income Tax at the source*, but with liability to assessment in the hands of the recipients.

(*c*) Exemption of interest from *Income Tax and Super-tax*, so long as it is shown in the manner directed by the Treasury that the securities are *in the beneficial ownership of persons who are not ordinarily resident* in the United Kingdom.

(*d*) Exemption of securities from *all taxation*, present or future, including Estate Duty, so long as it is shown in the manner directed by the Treasury that the securities are *in the beneficial ownership of persons who are neither domiciled nor ordinarily resident in the United Kingdom.*

172. We sought from the Treasury and the Board of Inland Revenue an indication of the present policy in regard to these

privileges, and we may quote the following conclusion from a memorandum furnished to us on the subject:—

"Tax concessions have been frequently advocated as likely to make a particular issue attractive, in effect as an alternative either to a higher rate of interest or to a lower issue price. But such a concession can only be 'attractive' if the recipient both in fact receives, and still more thinks he is receiving, a bargain.

"Their radical defect from this point of view is the necessary uncertainty of their value to the recipient. He does not know what future rates of Income Tax will be, or, whatever the rate, what his future income will be, or (in the case of death duties) how soon and under what market conditions he will enjoy the privileges of tendering his securities at par (in lieu of market price) in payment of death duties. He naturally tends to estimate the advantages of a tax concession with a very safe margin in his own favour. In these circumstances it is hardly doubtful that the State does not in fact obtain in improved loan conditions anything approaching the real value of the tax concessions it gives. At best it is entering on a doubtful speculation instead of, as in the alternative of *e.g.* a lower issue price, facing a certainty, the financial effect of which is known to both parties.

"Mainly for this reason the policy in recent years has been definitely to get away from war concessions and to refuse them to new issues.

"In principle, special tax exemptions are objectionable (*a*) because they create special classes of persons free from general tax liabilities, (*b*) because it is very doubtful if the State in fact receives value for the tax concession, (*c*) because the concessions involve administrative complications. The only defence for such privileges is that in moments of emergency they may be unavoidable and that in dealing with a National Debt of £7,000 millions it may be impossible to avoid second-rate financial expedients."

173. We are in entire agreement with the policy which is indicated in this quotation, and we propose only to add a brief comment on the comparative importance of the concessions.

174. Financially we have little doubt that the most important concession is that which permits the payment of interest on registered and inscribed holdings without deduction of tax at the source. This subject was exhaustively considered by the Royal Commission on the Income Tax, which recommended in 1920 that all British Government and Municipal loans should in future be made subject to deduction of tax at the source. The soundness of this recommendation is, we think, generally recognised.

175. The exemption of beneficial owners not ordinarily resident in the United Kingdom is related to this concession in that non-deduction at the source would necessarily mean in the vast majority of cases the effective exemption of such holders, since, in the absence of deduction, there is normally no machinery for

securing assessment of, and collection from, the recipient. It would, therefore, be useless to abolish the exemption of persons not ordinarily resident while retaining non-deduction at the source.

176. There are no available data by which the effect of this exemption can be measured. In general, since it must make the effective yield of British Government securities more nearly equal to that on British industrial securities which suffer tax, we surmise that it tends to attract such foreign capital as is invested in this country into Government securities rather than into industrials. To the extent to which this sets free for industry in this country the capital of British investors (and thus preserves British control of industries) the tendency is not undesirable. But, except so far as the exemption attracts money to this country which would not otherwise be invested here, there is a loss of Income Tax and, of course, no benefit by way of addition to the available capital of the country. A further aspect of the exemption is that it provides a favourable investment for persons who, in order to avoid taxation in this country, become resident abroad; since the alternative of investing in foreign securities is, however, always open, it is doubtful whether this point is of very much weight. Although the privilege may on the whole tend to increase the supply of capital in this country and thus to lower the rate of interest, we do not think the advantages secured are of such substance as in normal circumstances to justify the concession. We do not wish to be understood to express any objection to the exemption of holdings by non-residents where such exemption may form part of the general policy of the " reciprocal exemption of the non-resident " adopted with other States for the relief of double taxation.

177. Those loans which are issued subject to the payment of interest tax-compounded naturally appeal only to investors who are liable to Income Tax at the full rate, since in no case can the taxpayer obtain repayment of the Income Tax notionally paid. The market is thus restricted, and the terms of issue, to be successful, must accord with the investor's views as to the rate of tax likely to be in force during the currency of the loan. On that point the investor is likely to make a very conservative estimate of his possible gain. The value of issuing this type of loan must necessarily depend in the main upon general conditions at the time of issue, but we doubt whether sufficient compensation will be obtained in the terms of issue to justify the taxation concession involved.

178. Under the present taxation system, the complete exemption from taxation of the person both resident and domiciled abroad merely adds to the exemption from income taxation given to holders resident abroad an exemption from Estate Duty. There is little evidence to show that this privilege has been fruitful in attracting capital to this country.

179. All of these exemptions were devised with a view to attracting capital for war purposes, and they will continue for the life of the loans to which they were attached. But with the passing of the really urgent need for securing every available financial assistance, we feel that they should, as far as possible, cease to be attached to future issues. Indeed, in view of the large mass of securities which already carry the privileges, we doubt whether their repetition would exercise much effect on any future subscriptions from abroad.

180. One other privilege remains to be mentioned. Most of the issues of National War Bonds, the 5 per cent. War Loan, 4 per cent. War Loan, 4 per cent. Funding Loan, and Victory Bonds are accepted by the Commissioners of Inland Revenue in satisfaction of amounts due on account of death duties (and, as regards the National War Bonds, for Excess Profits Duty or Munitions Exchequer Payments) subject to certain specified conditions requiring that stock shall have been held for six months before the date of death (or before the duty is payable).

181. In most cases these securities can be tendered at their nominal value, but in the case of the 5 per cent. War Loan acceptance is at the issue price of 95 per cent. and in the case of 4 per cent. Funding Loan at the issue price of 80 per cent. Such a privilege is valueless to the holder unless it covers some bonus or special monetary advantage; it is apt to work exceedingly unequally as between individuals, and it involves a concealed loss to the Exchequer. While under the stress of war borrowing, the concession was, perhaps, justifiable, we are glad to note that it has not been repeated in later issues.

THE INTEREST CHARGE.

182. We have dealt so far mainly with changes in the capital of the debt. It is necessary now to examine the changes which have taken place in the interest charge. Excluding the cost of management and expenses of issue, the actual charge for interest in 1920-21 was just over £326 millions, against practically £307 millions in 1925-26. The reduction is therefore £19 millions. In the former year, however, only £289,000 was paid in respect of interest on the debt to the United States Government. Under the terms of the Funding Agreement of 1923, the interest charge on this loan in 1925-26 involved the issue from the Exchequer of somewhat over £28 millions. The reduction effected in the interest charge on other items of the debt was thus rather more than £47 millions.

183. This reduction was, of course, due to (*a*) the large repayments of debt out of revenue and other receipts, (*b*) savings resulting from direct conversion operations, and (*c*) savings due to the repayment of debt out of reborrowings, in which may be included the substantial gain accruing from the fall in the rate of interest payable on Treasury Bills. Since, as indicated in

paragraph 119, it is not possible to identify all the individual items of debt repaid with the particular source of the cash applied, the proportion of the total saving due to each of these factors cannot be exactly determined.

Some guidance can, however, be obtained from the more detailed comparison of the interest payments in 1920-21 and 1925-26 given in the following table :—

Interest on	Issues 1920-21.	Issues 1925-26.	Increase in 1925-26.	Decrease in 1925-26.
	(£ thousands).			
Consols, etc.	7,880	7,848	—	32
3½% Conversion Loan	—	25,351	25,351	—
Terminable Annuities	526	402	—	124
Treasury Bills	69,019	25,291	—	43,728
Ways and Means Advances ...	5,949	1,881	—	4,068
3½%, 4% and 4½% War Loan	5,410	5,406	—	4
5% War Loan	98,242	100,442	2,200	—
4% Funding Loan	16,328	15,768	—	560
4½% Conversion Loan	—	9,476	9,476	—
4% Victory Bonds	14,350	13,948	—	402
Exchequer Bonds	16,715	469	—	16,246
National War Bonds	71,305	36,271	—	35,034
Treasury Bonds	311	23,910	23,599	—
National Savings Certificates ...	2,519	7,103	4,584	—
U.S.A. Government Loan ...	289	28,315	28,026	—
Other debt (mainly external)...	17,231	5,114	—	12,117
	326,074	306,995	93,236	112,315

Net decrease £19,079.

184. The outstanding item in this table is the reduction in the total interest payable on Treasury Bills. A part of this decrease is, of course, offset by the interest on other forms of debt from the proceeds of which Bills were repaid. The actual reduction in the volume of Bills, comparing the commencement and end of the period, was £540 millions, but the volume outstanding at any point in the year is naturally subject to variation. Since the average rate of interest paid on Bills in 1920-21 was about £6 9s. per cent., the saving of interest due to these repayments may be roughly put at about £32 millions. The fall in the average rate of interest to about £4 5s. in 1925-26 may be taken to have reduced the charge on Bills still outstanding by, say, £12 millions.

The fall in interest on Ways and Means advances appears to be due in the main to the replacement of bank advances by advances from public departments, rather than to the diminution in the volume of those advances.

185. If we exclude the changes in the interest charge due to the reduction of the Floating Debt and the lower rate of

interest paid on the amount still outstanding, there is an increase in the period of £28,717,000, of which the interest on the debt to the United States Government accounts for £28,026,000. The increase as the result of other alterations in the debt is thus £691,000. Very largely, of course, the changes in the items of debt are due to conversion operations, including identifiable re-borrowings, which resulted in a saving of £1,553,000 (excluding transactions prior to 1st April, 1920). Thus the net effect of all other operations on the debt was to increase the interest charge by £2,244,000; that is to say, general borrowings not identifiable directly with a particular item of debt redeemed have increased the interest charge by that figure.

186. It has to be borne in mind that, as mentioned in paragraph 70, the interest on Savings Certificates represents the actual amount paid in the year upon repaid certificates. The charge, therefore, bears no fixed relation to the volume of certificates outstanding. The increased charge in the above table appears, however, on a rough approximation, to correspond closely with the increase which would have been necessary had accruing interest been paid in full There is, therefore, no disturbing element in the general comparison.

187. The considerations set out above suggest that the reduction of £47 millions in the interest charge since 1920-21 (*para.* 182) is due, as to £12 millions, to the lower rate of interest now payable on Treasury Bills; as to £4 millions to the change in the source of Ways and Means advances; as to £1½ millions to conversion operations and identifiable reborrowings; and as to the balance of £29½ millions to the repayment of debt out of revenue, &c., The latter figure is probably somewhat lower than the gross reduction, owing to a small increase in the charge resulting from minor changes in the form of the debt. This allocation must, however, be regarded as illustrative rather than as being the result of definite calculations. Apart from the difficulties referred to above, some disturbance naturally arises from the fact that the interest charge is actually paid on a volume of debt which differs from that outstanding at the beginning or end of the year.

188. Although, therefore, these figures can only be offered as a rough estimate, they are, we think, sufficiently close to show that the reduction is due in the main to two factors—the very large sums which have been provided for debt redemption out of revenue, and the considerable scope for saving afforded over the period by the fall in short money rates, a fall no doubt largely due to the sound financial policy followed by the Government. On the former item alone, assuming that debt has been redeemed at 5 per cent., the saving would be almost £33 millions. Up to the present time the saving effected by conversion operations has, as was to

be anticipated, been small, and obviously the future gain which may be secured from such operations depends entirely upon the continuance of a decline in the general rate of interest.

189. The witnesses who have appeared before us have expressed no very pronounced views on this question. Dr. Dalton was of opinion that during the next 10 years there was unlikely to be any scope for downward conversion except in the case of the 5½ per cent. and 5 per cent. issues, and in default of straightforward repayment, upward conversion would be necessary in the case of some of the other items (*Ev. p.* 394 : *E in C* : 8). Professor Cannan thought that on the whole the probability was in favour of some reduction by conversion, but not a great one (Q. 838-40)

190. We are not ourselves prepared to make any prophecy regarding future interest rates. While over a period there is ground for hoping that a downward movement will be shown—and the policy in regard to debt repayment may itself exercise some influence in this direction—it cannot be ignored that in certain circumstances, such as a trade revival, an upward movement would probably be the initial result. Nor can it be overlooked that, whatever the general trend, temporary movements coinciding with the maturity of debt, may affect the terms of the new bargain to be made with holders of Government securities. But in view of the frequently expressed belief that a considerable saving is likely to be achieved by future conversions, we think it desirable to define clearly the utmost that could be gained in that direction upon certain arbitrary assumptions regarding the rate of interest which may be required to be paid upon conversion.

FUTURE CONVERSION OPERATIONS—LIMITS OF POSSIBLE SAVINGS.

191. We print in Appendix VII a table showing in round figures the internal debt maturing year by year, together with the present interest charge and the annual saving which would accrue if, at maturity, the debt were converted to a 4 per cent. basis or to a 3½ per cent. basis. For convenience of comparison the interest on 4 per cent. Income Tax compounded issues has been assumed to be equivalent to 5 per cent. taxable. If the tax compounded issues were actually to be converted into taxable loans, the saving on the interest charge would be less than is shown, but the method adopted facilitates comparison when account is taken of the decrease in tax revenue to which we refer later. It is clear that the opportunities of conversion are limited to the unfunded debt, and we may also exclude from consideration the issues of Funding Loan and Victory Bonds to which special redemption arrangements are attached. Leaving out of

account for the time being the Floating Debt and Savings Certificates, it will be seen from the table that the remaining debt amounts to £3,598 millions, involving a present interest charge of £177 millions, or an average rate of interest of 4·92 per cent.

192. Taking first the assumption that each loan is converted at the date at which the Government is bound to redeem it, we find that the interest savings on the hypotheses taken would be as follows:—

Year.		Annual saving if converted to	
		4% basis.	3½% basis.
		£	£
1926-27	Treasury Bonds...	1,096,000	1,644,000
1927-28	National War Bonds and 3½% War Loan.	2,067,000	3,572,000
1928-29	National War Bonds	4,676,000	7,014,000
1929-30	Treasury Bonds and Exchequer Bonds	304,000	535,000
1930-31	Treasury Bonds...	2,021,000	2,695,000
1932-33	do.	606,000	1,213,000
1933-34	do.	122,000	547,000
	Up to 31st March 1934	10,892,000	17,220,000
1942-43	4% War Loan	649,000	974,000
1944-45	4½% Conversion Loan	1,053,000	2,106,000
1945-46	4½% War Loan	64,000	128,000
1947-48	5% War Loan	20,441,000	30,661,000
	Total Saving of Interest ...	33,099,000	51,089,000

In the case of two loans included in this table—the 3½ per cent. War Loan and 3 per cent. Exchequer Bonds—the interest charge would be slightly increased on the 4 per cent. basis, and, in the case of the latter loan only, on the 3½ per cent. basis.

193. The above summary shows the outstanding position in this connection of the 5 per cent. War Loan. It has also to be borne in mind that 5 per cent. National War Bonds are (with the exception of the fourth series), convertible into this loan at the option of the holder; if this option were fully exercised the amount of the 5 per cent. War Loan would be increased by nearly £500 millions. Similarly the 4 per cent. War Loan might be increased by nearly £140 millions by conversion of 4 per cent. Bonds. The interest saving shown as possible in 1927-28 would then be entirely postponed, and that shown as possible in 1928-29 would be mainly postponed, until the year 1947-48, with a slight alteration in the amount, owing to the fact that conversion of 5 per cent. Bonds is on the basis of £95 bonds for each £100 War Loan.

194. If we now examine the position on the assumption that the Government were able to convert at the earliest dates at which it has an option to redeem loans, the interest savings year by year would be as follows :—

Year.	—	Annual saving if converted to	
		4% basis.	3½% basis.
		£	£
(After 1925-26)	4½% War Loan	64,000	128,000
1926-27	Treasury Bonds...	1,218,000	1,887,000
1927-28	National War Bonds and 3½% War Loan.	2,067,000	3,572,000
1928-29	National War Bonds	4,676,000	7,014,000
1929-30	5% War Loan, Treasury Bonds and Exchequer Bonds.	21,394,000	32,170,000
1930-31	Treasury Bonds...	2,627,000	3,908,000
1931-32	Treasury Bonds...	—	304,000
	Up to 31st March, 1932	32,046,000	48,983,000
1939-40	4½% Conversion Loan	1,053,000	2,106,000
	Total Saving of Interest ...	33,099,000	51,089,000

The principal change in the date at which a saving might be made arises, of course, from the option to repay the 5 per cent. War Loan on the 1st June, 1929. If circumstances should enable that option to be exercised, conversions of National War Bonds into 5 per cent. War Loan will result in only a slight lengthening of their life.

195. We have excluded from these statements the external debt, Floating Debt and Savings Certificates. As regards the external debt some £29 millions of 20 year bonds due in 1936-37 are convertible at the option of the holder into 5 per cent. National War Bonds on terms which involve a small increase in the interest charge; practically all the remainder is now in annuity form, with the exception of a part of the loans from certain Allied Governments which may be regarded as available for set-off against loans to those Governments. In the case of the Floating Debt, it can only be said that, so far as it may be converted into longer term debt, it is to be anticipated that, whatever the course of interest rates may be, there will be some increase over the cost of maintaining it in its present form; it is clear that there is no possibility of a fall in the future rate of interest on this debt of the dimensions registered in the past few years. We have already mentioned the position regarding the provision of interest on Savings Certificates (*para.* 70). The

facilities recently announced for the conversion of certificates of the first issue into a new Savings Bond or into 4½ per cent. Conversion Loan will, so far as they are accepted, relieve the Treasury from the obligation which would otherwise have arisen to pay in cash the past accumulated interest on those certificates, and the terms offered on the new securities represent a small saving on the real interest charge on certificates of the first issue.

196. It remains to mention one further point of considerable importance in connection with the possible saving of interest through conversions. The reduction in the interest charge, taken by itself, naturally involves a reduction in the income which is assessed to Income Tax and Super-tax, and therefore a reduction on the revenue side of the Budget as well as in the interest on the expenditure side. We have no data for the assessment of this loss of revenue, but if we assume that the loss in tax is 4s. in the £, the net saving in the Budget would be reduced to about £26 millions in the event of conversion to a 4 per cent. basis, or to £41 millions on a 3½ per cent. basis. Actually at present rates of Income Tax and Super-tax, the loss of revenue is likely to be considerably more.

THE PRICE LEVEL AND THE DEBT BURDEN.

197. Whatever saving may actually be achieved in the long run by conversion and repayment operations, it has to be borne in mind that there is not necessarily a corresponding relief in the burden of the interest charge on the taxpayer. That charge is fixed in terms of money and unless the fall in the money transfer exceeds the fall in commodity values, the burden is not diminished.

198. The relation of the burden of the repayment of debt to changes in the price level is of particular significance in connection with proposals for a Capital Levy, and we deal with it in the main under that head (*para.* 737 *et seq.*). With regard to the interest charge, it is sufficient here to point out that, if prices fall from any cause other than a compensating increase of or economy in production, profits will also fall and the taxable area will be reduced in terms of money. But a fall in prices brings no corresponding reduction in the charge for interest on the debt, except so far as the sympathetic relation of interest and prices enables conversions to be effected. Thus the proportion of production taken to pay the interest on the debt tends to increase as the prive level falls. In other words the relative as well as the absolute purchasing power of the interest receiver rises. Correspondingly of course an increase in prices, unaccompanied by a compensating fall in production, diminishes the relative purchasing power of the fixed interest receiver.

199. The following table shows the charge for internal debt interest reduced to the pre-war level of prices on the basis of the Statist index number (an average of the four quarters being taken) :—

Year.	Internal Debt Interest.	Statist Index No.	Internal Debt Interest at Pre-war Prices.
	(£ thousands.)	(1913=100.)	(£ thousands.)
1918–19	219,265	226·1	97,000
1919–20	283,780	261·1	109,000
1920–21	308,664	270·6	114,000
1921–22	285,562	171·8	166,000
1922–23	265,671	154·7	172,000
1923–24	269,914	154·3	175,000
1924–25	272,777	166·1	164,000
1925–26	273,655	155·1	176,000

200. Thus despite a small decrease in the internal interest charge since 1919-20, the absolute burden measured in pre-war prices (wholesale) had increased by nearly 61 per cent. in 1923-24; 51 per cent. in 1924-25; and 61 per cent. in 1925-26. It is, however, important to note that the bulk of the internal borrowings were in fact incurred prior to 1919-20, when the price level was lower than in that year (*cf. para.* 738). The figures should not therefore be taken as measuring an increase in purchasing power transferred to the interest receiver over that which he transferred to the State at the time of borrowing; in other words in 1919-20 the interest receiver was suffering a reduction of his previous purchasing power.

201. On the evidence given by Mr. Layton, there was, however, an increase of production in the years 1922 and 1923 as compared with 1921. Taking his estimate of the national income (including debt interest and war pensions) we find that the proportion of that taxable income required to meet the internal debt interest is as follows :—

Calendar Year.	Total National Income.	Internal Debt Interest (Financial Year).	Ratio of Debt Interest to National Income.
	(£ mills.)	(£ mills.)	%
1920	5,600	309	5·5
1921	3,900	286	7·3
1922	3,500	266	7·6
1923	3,800	270	7·1

202. On this basis the increase in the relative weight of the burden in 1923 as compared with 1920 was 29 per cent. All the comparisons we have given can, however, in the nature of things be regarded only as a general indication of the course of the burden. As such they

show that the reduction in the interest charge in the past few years has been insufficient to compensate the fall in prices. For the future, as we indicate in connection with the Capital Levy (*para.* 742), the evidence before us does not point to any strong or definite movement in general prices. In such circumstances it is to be anticipated that reductions in the interest charge will produce some diminution in the real burden. At the same time we are of opinion that the review which we have made of the possibilities of savings from conversions does not justify the placing of any very great reliance upon such operations as a means of effecting a really appreciable mitigation in the early future.

THE SINKING FUNDS.

203. We have, in the course of reviewing the various debt transactions and in Appendix V, made brief reference to the provision for debt redemption. Before setting out more specifically the present position, it may be of interest to trace shortly the development of the Sinking Funds.

204. The record of the earliest efforts to establish a fund for the redemption of debt in this country shows one long series of failures. It was not until after the enunciation by Dr. Hamilton in 1814 of the principle "that the excess of revenue over expenditure is the only real sinking fund by which public debt can be discharged," and the endorsement of this principle by a Select Committee of the House of Commons in 1828, that any real attempt was made to place the Sinking Fund upon a sound basis. In 1829 all the earlier legislation on the subject was repealed, and it was enacted that the actual surplus revenue should be issued to the National Debt Commissioners to be applied by them to the redemption of debt. This provision came to be known as the Old Sinking Fund, and when in 1875 Sir Stafford Northcote brought forward a new scheme for debt repayment, the Old Sinking Fund was retained with some alteration in machinery, under which it was directed to be issued to the National Debt Commissioners in the course of the year following that in which the surplus arose. The application of the Old Sinking Fund has been modified in recent years by provisions under which accruing surplus revenue may be applied directly by the Treasury during the current year, instead of being issued to the National Debt Commissioners in the following year.

205. It was the opinion of the Select Committee referred to above that an annual surplus of £3,000,000 should be provided, but in fact no serious effort appears to have been made to give effect to this recommendation and the amounts actually realised were generally small. In these circumstances Parliament, at the instance of Sir Stafford Northcote, made provision in 1875 for the acceleration of debt repayment through the establishment of a permanent or fixed annual debt charge. The principle of this

charge was that it should cover not only the entire service of the debt (that is, the payment of interest, terminable annuities, management, and specific Sinking Funds) but that it should also leave a margin which should be applicable to redeem debt, and which would itself automatically increase as the charge for interest fell owing to the reduction in the debt. This margin was known as the New Sinking Fund.

206. The amount of the fixed debt charge was originally fixed at £27,400,000 for 1875-6, £27,700,000 for 1876-7 and £28,000,000 for every subsequent financial year, and it was directed that all perpetual or terminable annuities charged on the Consolidated Fund by any Act prior to 1875 should be paid out of the permanent annual charge. In the first year of operation, the amount issued in respect of New Sinking Fund and principal of terminable annuities was £4,092,221 or 0·534 upon the total deadweight debt then existing.

207. The amount of the fixed debt charge was altered from time to time, notably in 1887-8 to £26 millions, in 1889-90 to £25 millions and in 1899-1900 to £23 millions. In the year before the war (1913-14) it stood at £24½ millions, and the New Sinking Fund then amounted to £5,228,000 or about 0·8 per cent. on the total debt. The principal of terminable annuities amounted to £2,377,880 so that the total issued for debt redemption out of the fixed debt charge was £7,605,880, representing 1·15 per cent. on the total debt.

208. It was proposed in the Budget of 1914-15 to reduce the fixed debt charge to £23½ millions. On the outbreak of war, however, the payment of the New Sinking Fund was suspended, with the exception of £1,000,000 applied to the redemption of drawn Exchequer Bonds. The suspension continued up to the end of 1919-20, but the New Sinking Fund was resumed for the two following years. In 1922-23 as a temporary measure the New Sinking Fund was again suspended, and in the following year the basis was (*as shown in para.* 211) entirely altered.

209. Turning now to the changes in the position brought about by the Great War, it is of consequence to note that the debt then created was never brought within the "fixed debt charge." That charge was consequently an insignificant proportion of the total which had to be provided for the service of the debt. On the other hand certain specific Sinking Funds were attached to loans issued during the War, and other provisions in connexion with certain of those loans, such as the arrangement for their acceptance in payment of death duties, operated in much the same way as a Sinking Fund.

210. The particulars of these specific Sinking Funds are as follows :—

(*a*) 3½ *per cent. Conversion Loan.*—Under Section 45 of the Finance Act, 1921, the Treasury must issue from the Consolidated Fund as soon as may be after the close of each

half year during which the average daily price of the loan certified by the Bank of England has been below £90 per cent., a sum equal to not less than 1 per cent. of the amount of the loan outstanding at the close of that half year to be applied in the purchase of Conversion Loan for cancellation. The amount thus issued in 1925-26 was £14,386,000.

(*b*) 4 *per cent. Victory Bonds and* 4 *per cent. Funding Loan* 1960-90.—Under Section 2 of the War Loan Act, 1919, the Treasury are required to set aside at the close of each half-year a sum equal to 2¼ per cent. on the nominal amount of any 4 per cent. Victory Bonds or 4 per cent. Funding Loan originally created under the prospectuses dated 12th June, 1919 (together £768,640,000), and, after deducting therefrom the amount required for the payment of interest on those securities for the half year, to issue to the National Debt Commissioners the balance of the sum so set aside to be applied by them to Sinking Fund purposes in accordance with the prospectuses. In the case of Victory Bonds the Sinking Fund is applied to annual drawings at par. In the case of Funding Loan it is applied to purchase and cancellation while the loan is below par, but may be invested if the price is above par. The amount required for these loans in 1925-26 was £4,873,000.

(*c*) The Life Annuities and Terminable Annuities charged on the Consolidated Fund include capital repayments which amounted in 1925-26 to £1,085,000.

(*d*) Under the arrangement for the funding of the British debt to the United States of America annual instalments of principal, commencing at $23,000,000 in 1923-24 and increasing to $175,000,000 in 1984-5, are to be paid.

(*e*) Under the terms of issue of 4 per cent. Victory Bonds, the bonds, which were issued at 85, are accepted at par in payment of death duties, and under Section 3 of the War Loan Act, 1919, bonds so tendered are purchased by the National Debt Commissioners from the Inland Revenue Commissioners and held until drawn. Any sums received by the National Debt Commissioners by way of interest or repayment of principal in respect of securities transferred to them may be applied in payments to the Inland Revenue, any further requirements to meet such payments being met from the Consolidated Fund. The sum required from the Consolidated Fund for this purpose in 1925-26 was £6,995,000.

A similar provision exists for the acceptance in the payment of death duties of Funding Loan at the issue price (80) but as long as the quotation of this stock exceeds the acceptance value it is obviously unlikely to be tendered in settlement of duties. The same considerations apply generally to certain other securities which may be tendered in payment of death duties or Excess Profits Duty.

(*f*) *Depreciation Fund* for 5 per cent. War Loan 1929-47 and 4 per cent. War Loan (tax compounded) 1929-42.—The prospectuses of these loans provide that there shall be set aside monthly as a depreciation fund for purchasing for cancellation, whenever the market price falls below 95 in the case of 5 per cent. loan or 100 in the case of 4 per cent. loan, one-eighth per cent. on the original amount of the loan. Whenever the unexpended balance in the hands of the National Debt Commissioners reaches £10,000,000, issues to them are to be suspended. In the year 1925-26 the issues, which were required in respect of the 4 per cent. loan only, were £7,539,000.

211. The existing provisions regulating the total Sinking Fund to be applied in the year were laid down by the Finance Act of 1923, which repealed the fixed debt charge arrangement of 1875 and set up a definite annual provision for Sinking Funds of £40,000,000 for 1923-24, £45,000,000 for 1924-25 and £50,000,000 in subsequent years unless and until Parliament otherwise determines. The annual amounts fixed by this Act include the sums which fall to be issued under the specific Sinking Funds referred to above and also that portion of any terminable annuities which represents principal.

212. The allocation of the New Sinking Fund (1923) in 1924-25 and 1925-26 is shown in the following table :—

—	1924–25.			1925–26.		
	Amount included in Sinking Fund,	Nominal Debt, 1 April, 1924.	Percentage of S.F. to Nominal Debt.	Amount included in Sinking Fund.	Nominal Debt, 1 April, 1925.	Percentage of S.F. to Nominal Debt.
	(£000)	(£000)	%	(£000)	(£000)	%
3½ % Conversion Loan	13,239	666,231	1·99	14,386	708,931	2·03
4 % Funding Loan and Victory Bonds	4,673	749,660	0·62	4,873	744,670	0·65
Terminable Annuities	1,813	13,451	13·48	1,085	13,053	8·03
U.S.A. Government Loan	5,202	940,479	0·55	4,953	935,753	0·53
Bonds surrendered in payment of death duties	7,846	—	—	7,173	—	—
	32,773	2,369,821	1·38	32,470	2,402,407	1·35
Balance ...	12,227	5,310,802	0·23	17,530	5,243,965	0·33
	45,000	7,680,623	0·59	50,000	7,646,372	0·65

In 1925-26, owing to the fall of the 4 per cent. War Loan below par, Depreciation Fund issues amounting to £7,539,000 were necessary and the free balance was thereby reduced to £9,991,000.

213. By far the greater part of the New Sinking Fund (1923) is at present therefore hypothecated to particular items of debt. As regards the future, requirements for the Funding Loan, Victory Bonds and the debt to the United States Government (excepting variations due to exchange) can be foreseen; in each case the redemption provision increases, as the interest decreases as the result of redemption. The following table shows the approximate provision for various years :—

—	1926-7	1930-31	1940-41	1950-51
	(£ thousands)			
Funding Loan	2,800	3,300	5,130	7,970
Victory Bonds	2,320	2,714	4,018	5,947
U.S.A. Government Loan (at par)	5,137	5,753	8,630	10,890
	10,257	11,767	17,778	24,807

214. The remaining items, with the exception of terminable annuities, are clearly liable to considerable changes mainly dependent upon the course of market values. The Conversion Loan Sinking Fund, which runs while the stock is below 90 (that is, until the yield on the stock is just below 4 per cent.) will obviously continue for a considerable period, diminishing slightly as stock is redeemed. A liability of about £15,000,000 a year, very gradually falling, is therefore to be anticipated.

The Depreciation Fund is a heavy contingent charge entirely dependent upon the market price of the loans to which it is attached; no reliable estimate of the future requirement can be made. The future issues for the purchase of securities tendered for death duties are also uncertain; so long, however, as Victory Bonds are below par, they are likely to be very substantial.

215. On the whole there is unlikely to be any very considerable change in the next decade from the present free balance of about £17 millions, less such issues as are needed in respect of the Depreciation Fund. Thereafter, unless and until the provision for Conversion Loan is no longer required, the free balance will tend to fall as the result of the increasing fixed charges shown in paragraph 213.

216. We may mention here a suggestion made to us by Dr. Dalton (in conjunction with proposals for an increased Sinking Fund) that specific Sinking Funds should be attached to the 4½ per cent. Conversion Loan and the 4 per cent. Victory Bonds (as an addition to the present drawings) with a view to raising

the market values of those securities, of which he thought additional issues at par might well be made when national credit reached a 4½ per cent. and 4 per cent. basis respectively (*Ev. p.* 394 : *E. in C.* 9). At the same time Dr. Dalton stated on the general question that he did not think the whole of the Sinking Fund provision should be attached to specific loans (Q. 5481).

217. We are of opinion that in the disturbed circumstances under which loans had to be raised during and immediately after the War period, the attachment of specific Sinking Funds (including the Depreciation Fund) in certain cases proved to be of distinct advantage in securing the success of the loans. From the point of view of the use of the Sinking Fund in raising Government credit and facilitating operations under more settled conditions, we are, however, inclined to think that definite attachment to particular loans tends to be disadvantageous. The present specific Sinking Funds are in the main attached to the longer term loans, and in one case to funded debt; that means that, upon the maturity of short issues, reborrowing (or conversion) has to be *pro tanto* greater than if the whole Sinking Fund had been free and available for such payments. The repayment of one type of stock side by side with reborrowing in another type is probably on the whole more disturbing to values than a simple reborrowing of a smaller sum. Nor can it be foreseen with any certainty that the stock to which a Sinking Fund is attached will prove to be that which over a long period it is most desirable to support. Leaving out of account the possibility that hypothecation may be a means of ensuring the continuance of the Sinking Fund provision (a matter which we discuss later), the ends in view can be equally secured by a judicious use of a free Sinking Fund; on the whole we do not therefore favour any extension of the earmarking of the Sinking Fund to particular securities.

SECTION III.

THE GROWTH AND PRESENT WEIGHT OF TAXATION: THE BURDEN OF TAXATION, DIRECT AND INDIRECT, ON VARIOUS INCOMES.

THE GROWTH AND PRESENT WEIGHT OF TAXATION.

218. We include in Appendices VIII and IX particulars of the rates at which the principal direct and indirect taxes have been charged from 1913-14 onwards, and we shall deal in due course with the weight of existing taxation under its several heads. It may be convenient, however, if we set out at once figures of the total net receipts for the years 1913-14 to 1925-26, distinguishing the main heads of duty.

TOTAL NET RECEIPTS, 1913-14 TO 1925-26.

(1) *Inland Revenue Duties.*
(2) *Customs and Excise Duties.*

—	1913-14.	1914-15.	1915-16.	1916-17.	1917-18.	1918-19.	1919-20.	1920-21.	1921-22.*	1922-23.†	1923-24.†	1924-25.†	1925-26.†
(1) *Inland Revenue Duties.*	£ thousands	£ thousands	£ thousands	£ thousands	£ thousands	£ thousands	£ thousands	£ thousands	£ thousands	£ thousands	£ thousands	£ thousands	£ thousands
Income Tax ..	43,902	59,424	112,373	186,538	214,857	257,708	317,030	340,665	334,934	314,375	271,433	275,456	258,065
Super-tax	3,339	10,121	16,788	19,140	23,279	35,560	42,405	55,069	61,351	63,910	61,747	62,989	67,833
Death Duties:—													
Estate Duty ..	21,649	22,368	24,363	25,093	25,742	25,144	36,638	40,614	45,146	48,463	49,805	50,514	52,861
Legacy and Succession Duties, etc.	5,517	6,175	6,574	6,095	5,993	5,656	6,122	6,567	7,375	8,031	7,752	8,403	8,469
Stamp Duties ..	9,983	7,435	6,780	7,764	8,554	12,417	22,891	26,541	19,577	21,851	21,579	22,758	25,129
Inhabited House Duty	1,994	1,886	1,975	1,888	1,941	1,859	1,935	1,956	1,943	2,076	1,900	491	25
Land Tax	690	661	680	653	633	643	671	650	578	643	618	722	673
Excess Profits Duty	—	—	188	141,615	223,116	283,977	289,208	218,099	29,671	1,123	−1,867‡	2,758	2,383
Corporation Profits Tax	—	—	—	—	—	—	—	701	17,704	18,815	23,451	18,005	11,705
Land Values Duties	735	414	369	524	651	710	651	− 308‡	450	217	239	253	282
	87,809	108,484	170,090	389,315	504,816	623,674	717,551	691,154	518,729	479,504	436,717	442,349	427,403
(2) *Customs and Excise Duties.*													
Tea	6,499	8,628	13,962	14,312	12,519	16,054	17,747	16,861	17,582	11,144	10,731	5,971	5,780
Sugar, etc.	3,328	3,266	9,023	18,329	15,407	28,098	42,946	30,414	36,760	38,470	38,117	20,532	19,371
Other Foods ..	1,078	1,076	1,874	2,797	3,217	3,546	4,227	3,149	3,329	2,555	2,680	1,650	1,549
Tobacco	18,284	19,302	25,781	27,372	33,320	46,292	60,871	55,532	55,208	50,831	51,882	51,913	53,497
Spirits	23,976	25,274	26,339	18,014	10,596	21,242	58,804	71,048	62,831	53,704	54,037	51,054	49,928
Beer	13,655	15,882	33,770	31,673	19,109	25,424	71,278	123,406	121,865	100,033	81,702	81,987	82,403
Wine	1,162	1,004	1,078	888	781	1,409	2,235	2,913	2,751	3,034	2,360	3,752	3,746
Entertainments ..	—	—	—	3,001	4,987	7,520	10,480	11,736	10,280	9,603	9,285	6,249	5,714
All other Duties ..	7,255	7,138	8,656	10,912	9,531	10,544	15,649	18,724	12,749	13,246	13,678	11,317	15,716
	75,227	81,570	120,783	127,198	109,467	163,129	283,336	333,813	323,355	282,620	265,481	234,425	237,704

* Excluding Estate Duties and Stamps collected in Northern Ireland after 21st November, 1921.
† Great Britain and Northern Ireland (Reserved Taxes). The Customs and Excise Figures for 1923-24, 1924-25 and 1925-26 exclude payments by the Irish Free State in respect of adjustments to make up the attributable revenue of 1922-23. The figures for 1922-23 represent the attributable revenue of that year.
‡ Repayments in excess of receipts.

219. It may be of interest to add figures of per head taxation, direct and indirect. These are not given for the years 1915-16 to 1919-20, for the reason that such population figures as are available for those years relate to the civil population only.

Taxation per head of population, 1913-14, 1914-15, and 1920-21 to 1925-26.

Motor Vehicle Duties excluded.

—	1913–14	1914–15	1920–21	1921–22	1922–23	1923–24	1924–25	1925–26
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Direct Taxation per head.	2 1 0	2 9 7	14 17 0	11 2 3	10 18 7	9 18 1	9 19 5	9 11 6
Indirect Taxation per head.	1 10 4	1 12 11	7 0 2	6 15 0	6 3 11	5 17 10	5 2 2	5 2 11
Percentage relation of indirect to direct taxation.	74·0	66·4	47·2	60·7	56·7	59·5	51·2	53·7

This table follows the usual official classification under which all taxes levied in respect of consumable articles (i.e., all Customs Duties and all Excise Duties excepting Licences and Railway Duty) are regarded as indirect.

THE BURDEN OF TAXATION, DIRECT AND INDIRECT, ON VARIOUS INCOMES.

220. In this section we propose to illustrate how the total burden of taxation, direct and indirect, may fall upon taxpayers at different levels of income. We examine the incidence of the taxes later : at this stage we make a general assumption that the burden of taxation is borne as intended, i.e., that direct taxes are borne by the payer and that indirect taxes are shifted by the payer and borne by the consumer. Our only concern, at present, is with the statistical aspect : we shall defer passing any judgment on the existing distribution of the tax burden until we have considered the purposes to which the revenue is applied, and have examined at some length the operation of the several taxes : these steps we will take in the succeeding parts of our enquiry.

221. In the main, both in general method and in detail, we propose to follow the lines adopted by Sir Herbert Samuel, when in January, 1919, he took as the subject of his presidential address to the Royal Statistical Society " The Taxation of the Various Classes of the People." We shall indeed adopt, or only slightly modify, many of his figures, and the wide extent of our indebtedness to him, which we at once acknowledge, will become apparent as we proceed. We have, however, pursued independent lines of calculation as regards tobacco and alcohol duties.

222. Sir Herbert took the year 1913-14 for comparison with 1918-19 in order to show the trend of war finance, and he took 1903-04 in order to assist the investigation of pre-war policy in matters of taxation. All his figures related to 1903-04, 1913-14 and 1918-19 : in addition to reviewing these years, we have added figures for 1923-24 and 1925-26. The figures for 1925-26 reflect the reductions in indirect taxation due to the Finance Act, 1924, as well as the alterations in the Income Tax, Super-tax and death duties effected by the Finance Act, 1925. We take the same points on the income scale as Sir Herbert Samuel. The income in every case is the statutory income as computed for Income Tax purposes : owing to the various bases of Income Tax assessment (including the well-known three years' average*) the statutory income may not in the individual case be a measure of the actual income of the year. For our purposes, however, it is necessary to assume a correspondence in order that there may be a common income to which indirect taxes as well as direct may be referred. We follow Sir Herbert's precedent in relating our figures to a family of two adults and three children. The three children are taken to be under 16 years of age, so that the statutory relief from Income Tax in respect of children is allowed for all three. It is to be understood that this family of two adults and three children, while quite frequent, is not the average family. According to the Census for 1921 the average number of children under 16, if all married couples are taken into account, was then about 1¼; if married couples without children are excluded, the average appears to have been about 2¼. But it seems better for illustrative purposes to take a number of children rather in excess of the average, since owing to obvious statistical difficulties we have to ignore the various other relatives and dependants who, while frequently earning independent incomes, may add to the household's total tax burden. In the case of the servant-keeping classes we follow Sir Herbert Samuel in treating the indirect taxes on food and drink consumed by the servants as in the long run not falling upon the employer.

223. We agree also in excluding certain taxes, the revenue from which cannot properly be allocated according to size of income. The Stamp Duties are the only existing taxes yielding a revenue of importance (£25 millions in 1925-26) which we omit; these duties fall mainly on the better-off classes, but they are mostly levied on occasional transactions of irregular frequency and have no clearly definable relation to the annual income of the individual. Sir Herbert Samuel treated the net revenue of the Post Office as taxation, but, however, the Post Office receipts may be analysed, they are, as a whole, officially

* The Finance Act, 1926, provides for the abolition of the three years' average basis of assessment in favour of assessment on the profits of the preceding year—the new basis to come into effect in 1927–28.

classified as non-tax revenue, and we therefore exclude them as being outside the scope of our enquiry.

INLAND REVENUE DUTIES.

(1) *Income Tax and Super-tax.*

224. No difficulty is involved in calculating the income taxation of a married man with three children. The actual precise amounts of tax appropriate to incomes of stated size and composition can be given, only subject to variation by reference to special reliefs (e.g., life assurance relief, dependant relative allowance, double Income Tax relief) which may apply in individual cases. The figures are not affected by the use, varying with personal habit, to which the income may be put. In general tables at the conclusion of this Section, which bring the various taxes together, we give figures of income taxation relating to the married individual with three children (1) where his income is wholly earned, and (2) where one-half of his income is earned. For comparative purposes we may give here, year by year, the figures relating to an unmarried individual, the whole of whose income is unearned or " investment " income.

Income Tax, and in certain cases Super-tax, payable by a single person with investment income.

Actual Income.	1903–4.	1913–14.			1918–19.		
	Income Tax.	Income Tax.	Super-tax.	Total.	Income Tax.	Super-tax.	Total.
£	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
150	—	—	—	—	4 10 0	—	4 10 0
200	1 16 8	2 6 8	—	2 6 8	12 0 0	—	12 0 0
500	16 0 10	20 8 4	—	20 8 4	60 0 0	—	60 0 0
1,000	45 16 8	58 6 8	—	58 6 8	187 10 0	—	187 10 0
2,000	91 13 4	116 13 4	—	116 13 4	525 0 0	—	525 0 0
5,000	229 3 4	291 13 4	—	291 13 4	1,500 0 0	287 10 0	1,787 10 0
10,000	458 6 8	583 6 8	175 0 0	758 6 8	3,000 0 0	1,187 10 0	4,187 10 0
20,000	916 13 4	1,166 13 4	425 0 0	1,591 13 4	6,000 0 0	3,437 10 0	9,437 10 0
50,000	2,291 13 4	2,916 13 4	1,175 0 0	4,091 13 4	15,000 0 0	10,187 10 0	25,187 10 0

Actual Income.	1923–24.			1925–26.		
	Income Tax.	Super-tax.	Total.	Income Tax.	Super-tax.	Total.
£	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
150	1 13 9	—	1 13 9	1 10 0	—	1 10 0
200	7 6 3	—	7 6 3	6 10 0	—	6 10 0
500	56 16 3	—	56 16 3	50 10 0	—	50 10 0
1,000	169 6 3	—	169 6 3	150 10 0	—	150 10 0
2,000	394 6 3	—	394 6 3	350 10 0	—	350 10 0
5,000	1,069 6 3	362 10 0	1,431 16 3	950 10 0	231 5 0	1,181 15 0
10,000	2,194 6 3	1,462 10 0	3,656 16 3	1,950 10 0	1,131 5 0	3,081 15 0
20,000	4,444 6 3	3,962 10 0	8,406 16 3	3,950 10 0	3,506 5 0	7,456 15 0
50,000	11,194 6 3	12,712 10 0	23,906 16 3	9,950 10 0	12,256 5 0	22,206 15 0

225. The Income Tax shown as chargeable for 1903-04 represents a flat rate of 11*d.* in the £, and that for 1913-14 a flat rate of 1*s.* 2*d.* in the £—except as regards the £200 and £500 incomes, which were affected in both years by abatements. The Income Tax figures for 1918-19 for incomes up to £2,000 reflect the application of rates rising from 3*s.* to 5*s.* 3*d.* in the £, under the scheme of graduation developed during the War: the larger incomes are charged uniformly at the normal rate of 6*s.* in the £, the Income Tax on £50,000 being thus ten times that on £5,000. The Income Tax figures for 1923-24 and 1925-26 involve effective rates of tax which continue to increase somewhat even in the highest incomes, this being due to the application of certain reliefs to all incomes, irrespective of size, under the new scheme of graduation introduced by the Finance Act, 1920 (*see Appendix* VIII).

226. The Super-tax was first introduced for the year 1909-10, and up to and including 1913-14 was charged on incomes exceeding £5,000 at a flat rate of 6*d.* for every £1 in excess of £3,000: for 1914-15 to 1917-18 inclusive incomes exceeding £3,000 were charged for every £1 in excess of £2,500 according to a graduated scale, which was heavily increased in 1915-16. For 1918-19 incomes exceeding £2,500 became chargeable in respect of the excess over £2,000, the rates again being increased. Under the Finance Act, 1920, liability commenced immediately above £2,000, for every £1 in excess of that amount, and the scale was once more stiffened. There was no further alteration until 1925-26, when the severity of the scale was modified (*see Appendix* VIII).

227. If the figures in the above table are related to the Income Tax and Super-tax figures in the general tables following paragraph 255, the following comparison can be drawn between the Income Tax position of the bachelor with investment income and that of the married man with three children, whose income is wholly earned: so far as Super-tax is concerned, the charge throughout is the same for one as for the other. It should be borne in mind that, as between the several years, the comparison has reference to the same *nominal* incomes, without regard to changes in the value of money.

1903-04.—The family man with earned income paid the same amount of tax as the bachelor with investment income.

1913-14.—Owing to relief in respect of children (for incomes up to £500) and differentiation in favour of earned income (for incomes up to £3,000) the family man with earned income paid very substantially less than the bachelor with investment income on an income of £200, £500, £1,000 or £2,000; he paid the same amount as the bachelor in the case of the four largest incomes.

1918-19.—Owing to increased family reliefs for small and moderate incomes (including a new relief in respect of the taxpayer's wife) the family man with £200 paid no tax, in spite of the general exemption limit being lower than in 1913-14 : with £500 earned income he paid rather less relatively to the bachelor with £500 investment income than in 1913-14.

On the other hand at £1,000 and at £2,000 the family man with earned income paid more relatively to the bachelor with investment income than in 1913-14. In 1913-14 a wholly earned income of any size not exceeding £2,000 paid tax at 9*d.* in the pound on each pound of income chargeable, which was 9/14ths of the rate for investment income : in 1918-19 a wholly earned income exceeding £500 and not exceeding £1,000 paid tax at 3*s.* in the pound, which was 4/5ths of the rate for an investment income of the same size, while a wholly earned income exceeding £1,500 and not exceeding £2,000 paid at 4*s.* 6*d.* in the pound, which was 6/7ths of the corresponding investment income rate. The four largest incomes remained unaffected by family or earned income reliefs.

1923-24 and *1925-26.*—Under the new scheme of graduation introduced in 1920 (*see Appendix* VIII) the position of the family man with earned income relatively to that of the bachelor with investment income was more favourable throughout than in 1918-19 and also (except at the £2,000 figure) than in 1913-14. It will be observed that family and earned income reliefs applied under the new graduation to the four largest incomes.

Death Duties.

228. We shall see (*para.* 454 *et seq.*) that the incidence of the death duties is not uniform, and in general is not clear-cut as between the testator and those who benefit under his will. On this account alone it would be necessary to give a warning that any figures connecting the death duties with a given income must be taken with reserve.

229. The burden which we relate to the individual in possession of capital wealth is that of the duties which will fall upon his estate when he dies, and not that of the duties which may have fallen on property inherited by him. This procedure is consonant with the usual incidence of the Estate Duty, but not with the usual incidence of the Legacy and Succession Duties. There is, however, no other means of calculating the burden of these latter duties in terms of a charge on income, and in fairness to the property-owning classes they cannot be omitted.

230. The question of incidence is only one of the difficulties. In the case of the Income Tax and the indirect taxes, we have to relate *annual* taxes to an individual with a given income in a given year, according to the rates of tax known to be in force. In the case of death duties, we have to relate to the same individual in terms of a charge upon his income—a *capital* liability, the actual amount of which will depend on his wealth, and various other factors, at an uncertain future date.

For illustration let us take the case of an individual who has an income of £50,000 in 1923-24, half being earned income and half being derived from an estate worth £500,000. What is desired is to take the death duties at the rates in force in 1923-24, and, so far as their burden is appropriate to this individual rather than his heir, to translate them into terms of an annual charge, as it falls upon his income in the year named.

In the first place it is impossible to say what the estate will be worth when the individual dies, and no one assumption appears to be justified rather than another—he may lose money or he may amass a large additional sum. In the second place, even if we—unlike the man himself—could know in advance that he would leave a fortune of, say, £1,500,000, we could hardly say that in 1923-24 he was already affected by the duties on £1,000,000 of wealth which had not come into existence. Further it seems incongruous to apply 1923-24 rates of duty to an estate passing in a year when these rates are no longer in force (the Estate Duty scale having in fact been modified already by the Finance Act, 1925).

231. The only way to escape from difficulties of this kind is to disclaim all knowledge of the future, and take the standpoint of the individual himself in 1923-24. He does not know when he will die, what his estate will then be worth, or what the rates of Estate Duty, Legacy Duty and Succession Duty will then be. What he can do, however, is to make some provision for death duties on a mere hypothesis as to the future. He can calculate what he will have to save in order to meet the duties and pass on a net £500,000, *if* on other accounts the value of the estate remains unaltered and *if* the same rates of Estate Duty etc. continue in force. He can take out a life policy to assure the capital sum required on this basis, and the premium may then be regarded as a charge falling upon his income on account of the prospective death duties.

232. We will proceed then on this plan. The method of treating the death duties as equivalent to an annual life insurance charge is indeed traditional, having been employed in a paper put before the Select Committee on the Income Tax in 1906 (*cf. para.* 459) and in answer to Parliamentary Questions, and having been adopted by Sir Herbert Samuel himself. But,

apart from certain differences of detail in our calculations, we have wished to make the limitations of the method quite clear. Our figures only claim; first, to illustrate the burden which may fall upon an individual with a given income if and when he takes out an insurance policy to provide for the death duties, and secondly, to give some picture—it is true, very rough—of the general burden on the more and the less wealthy taxpayer respectively.

The figures do not claim to represent an annual equivalent of the full duties which will actually become payable. Although anything may happen, it is likely that the estate—and with it the liability—may increase very considerably as the individual grows older, in accordance with the usual association between age and wealth revealed by Estate Duty statistics, and in such an event the premium may be quite inadequate to represent the actual death duties burden. On the other hand, as indicated above (*para.* 228) the incidence of the duties may be partly on the successors, and indeed is likely to be upon them so far as the Legacy and Succession Duties are concerned. These considerations have to be borne in mind, when our merely illustrative figures are related to the actual operation of the duties.

233. The following points are involved in our calculations :—

(1) In our first table we illustrate the burden of the death duties where the income is wholly from investments, and in our second table, where half the income is from investments : we capitalise on a 5 per cent. basis throughout, so that £1,000 income has £20,000 capital corresponding to it in our first table, and £10,000 capital corresponding to it in our second.

(2) The value of a life insurance policy itself forms part of the estate liable to duty, and is so treated.

(3) The liability to the minor death duties is calculated from the liability to Estate Duty, according to the proportion of revenue from the respective sources : only this rough procedure is possible, since the actual burden of the legacy and Succession Duties depends on the relationship between testator and beneficiary.

(4) It is assumed that the taxpayer takes out his life policy at the age of 45 : the Income Tax allowance given in respect of the premium is taken into account.

234. Our tables are given on the following pages.

Death Duties: Table 1.

Table of Annual Insurance Premiums, commencing at age 45, to insure a sum equal to the total Death Duties payable on certain specimen Estates (including the value of the Policy), and their ratio, as a tax, to the annual income from those Estates.

The taxpayer is assumed to be married, with three children under 16, and to draw all his income from investments.

Year.	Income	Equivalent Estate.	Equivalent Estate plus value of Policy.	Estate Duty payable. Rate.	Estate Duty payable. Amount.	Other Death Duties.	Total Death Duties payable.	Average Insurance Premium at age 45. Gross.	Income Tax Allowance.	Net.	Rate of Income Tax per £ of income equivalent to Net Premium.
	£	£	£	%	£	£	£	£ s.	£ s.	£ s.	s. d.
						27 %					
1903-04	50	1,000	1,039	3	31	8	39	1 5	—	1 5	6
	100	2,000	2,079	3	62	17	79	2 11	—	2 11	6
	150	3,000	3,119	3	94	25	119	3 16	—	3 16	6
	200	4,000	4,159	3	125	34	159	5 2	5	4 17	5½
	500	10,000	10,535	4	421	114	535	17 2	16	16 6	7½
	1,000	20,000	21,071	4	843	228	1,071	34 5	1 11	32 14	7½
	2,000	40,000	42,424	4½	1,919	515	2,424	77 12	3 11	74 1	9
	5,000	100,000	108,249	6	6,495	1,754	8,249	263 19	12 2	251 17	1 0
	10,000	200,000*	217,996	6½	14,170	3,826	17,996	575 17	26 8	549 9	1 1½
	20,000	400,000	439,030	7	30,732	8,298	39,030	1,248 19	57 5	1,191 14	1 2½
	50,000	1,000,000	1,113,090	8	89,047	24,043	113,090	3,618 18	165 17	3,453 1	1 4½
						25 %					
1913-14	50	1,000	1,039	3	31	8	39	1 5	—	1 5	6
	100	2,000	2,078	3	62	16	78	2 10	—	2 10	6
	150	3,000	3,117	3	94	23	117	3 15	—	3 15	6
	200	4,000	4,156	3	125	31	156	5 0	6	4 14	5½
	500	10,000	10,666	5	533	133	666	21 6	1 5	20 1	9½
	1,000	20,000	21,621	6	1,297	324	1,621	51 18	3 1	48 17	11½
	2,000	40,000	43,836	7	3,069	767	3,836	122 15	7 3	115 12	1 1½
	5,000	100,000	112,676	9	10,141	2,535	12,676	405 13	23 13	382 0	1 6½
	10,000	200,000	231,884	11	25,507	6,377	31,884	1,020 6	85 1*	935 5	1 10½
	20,000	400,000	470,588	12	56,470	14,118	70,588	2,258 16	188 5*	2,070 11	2 0½
	50,000	1,000,000	1,230,769	15	184,615	46,154	230,769	7,384 12	615 8*	6,769 4	2 8½
						22 %					
1918-19	100	2,000	2,076	3	62	14	76	2 9	—	2 9	6
	150	3,000	3,114	3	93	21	114	3 13	—	3 13	5½
	200	4,000	4,152	3	125	27	152	4 17	—	4 17	5½
	500	10,000	10,650	5	533	117	650	20 16	3 2	17 14	8½
	1,000	20,000	21,580	6	1,295	285	1,580	50 11	7 12	42 19	10½
	2,000	40,000	43,734	7	3,061	673	3,734	119 10	17 18	101 12	1 0½
	5,000	100,000	113,895	10	11,389	2,506	13,895	444 13	66 14	377 19	1 6½
	10,000	200,000	234,302	12	28,116	6,186	34,302	1,097 13	164 13	933 0	1 10½
	20,000	400,000	497,018	16	79,523	17,495	97,018	3,104 12	465 14	2,638 18	2 7½
	50,000	1,000,000	1,322,751	20	264,550	58,201	322,751	10,328 1	1,250 0	9,078 1	3 7½
						15 %					
1923-24	100	2,000	2,071	3	62	9	71	2 5	—	2 5	5½
	150	3,000	3,107	3	93	14	107	3 8	—	3 8	5½
	200	4,000	4,143	3	124	19	143	4 12	—	4 12	5½
	500	10,000	10,610	5	530	80	610	19 10	2 4	17 6	8½
	1,000	20,000	21,751	7	1,523	228	1,751	56 1	6 6	49 15	1 0
	2,000	40,000	45,198	10	4,520	678	5,198	166 7	18 14	147 13	1 5½
	5,000	100,000	120,846	15	18,127	2,719	20,846	667 1	75 1	592 0	2 4½
	10,000	200,000	263,678	21	55,372	8,306	63,678	2,037 14	187 10	1,850 4	3 8½
	20,000	400,000	570,613	26	148,359	22,254	170,613	5,459 12	375 0	5,084 12	5 1
	50,000	1,000,000	1,673,640	35	585,774	87,866	673,640	21,556 10	937 10	20,619 0	8 3
						12½ %					
1925-26	100	2,000	2,070	3	62	8	70	2 5	—	2 5	5½
	150	3,000	3,105	3	93	12	105	3 7	—	3 7	5½
	200	4,000	4,140	3	124	16	140	4 10	—	4 10	5½
	500	10,000	10,596	5	530	66	596	19 1	1 18	17 3	8½
	1,000	20,000	22,253	9	2,003	250	2,253	72 2	7 4	64 18	1 3½
	2,000	40,000	47,478	14	6,647	831	7,478	239 6	23 19	215 7	2 1½
	5,000	100,000	130,933	21	27,496	3,437	30,933	989 17	83 7	906 10	3 7½
	10,000	200,000	278,281	25	69,566	8,696	78,281	2,504 7	166 13	2,337 14	4 8
	20,000	400,000	583,942	28	163,504	20,438	183,942	5,886 3	333 7	5,552 16	5 6½
	50,000	1,000,000	1,649,484	35	577,319	72,165	649,484	20,783 10	833 7	19,950 3	7 11½

* Including Super-tax allowance.

N.B.—For 1918-19, 1923-24 and 1925-26, the policies are regarded as taken out after 22nd June, 1916.

Death Duties: Table 2.

Table of Annual Insurance Premiums, commencing at age 45, to insure a sum equal to the total Death Duties payable on certain specimen Estates (including the value of the Policy), and their ratio, as a tax, to the annual income from those Estates.

The taxpayer is assumed to be married, with three children under 16, and to draw half his income from investments and half from earnings.

Year.	Income.	Equivalent Estate.	Equivalent Estate plus value of Policy.	Estate Duty payable.		Other Death Duties.	Total Death Duties payable.	Average Insurance Premium at age 45.			Rate of Income Tax per £ of income equivalent to net Premium.
				Rate.	Amount.			Gross.	Income Tax Allowance.	Net.	
	£	£	£	%	£	£	£	£ s.	£ s.	£ s.	s. d.
						27 %					
1903-04	50	500	513	2	10	3	13	8	—	8	2
	100	1,000	1,039	3	31	8	39	1 5	—	1 5	3
	150	1,500	1,560	3	47	13	60	1 18	—	1 18	3
	200	2,000	2,079	3	62	17	79	2 11	2	2 9	3
	500	5,000	5,198	3	156	42	198	6 7	6	6 1	3
	1,000	10,000	10,535	4	421	114	535	17 2	16	16 6	4
	2,000	20,000	21,071	4	843	228	1,071	34 5	1 11	32 14	4
	5,000	50,000	53,391	5	2,670	721	3,391	108 10	4 19	103 11	5
	10,000	100,000	108,249	6	6,495	1,754	8,249	263 19	12 2	251 17	6
	20,000	200,000	217,996	6½	14,170	3,826	17,996	575 17	26 8	549 9	6½
	50,000	500,000	552,639	7½	41,448	11,191	52,639	1,684 9	77 4	1,607 5	7¾
						25 %					
1913-14	50	500	512	2	10	2	12	8	—	8	2
	100	1,000	1,039	3	31	8	39	1 5	—	1 5	3
	150	1,500	1,559	3	47	12	59	1 18	—	1 18	3
	200	2,000	2,078	3	62	16	78	2 10	2	2 8	3
	500	5,000	5,264	4	211	53	264	8 9	6	8 3	4
	1,000	10,000	10,666	5	533	133	666	21 6	16	20 10	5
	2,000	20,000	21,621	6	1,297	324	1,621	51 18	1 19	49 19	6
	5,000	50,000	54,795	7	3,836	959	4,795	153 9	8 19	144 10	7
	10,000	100,000	112,676	9	10,141	2,535	12,676	405 13	33 16*	371 17	9
	20,000	200,000	231,884	11	25,507	6,377	31,884	1,020 6	85 1*	935 5	11¼
	50,000	500,000	588,235	12	70,588	17,647	88,235	2,823 10	235 6*	2,588 4	1 0½
						22 %					
1918-19	100	1,000	1,038	3	31	7	38	1 4	—	1 4	3
	150	1,500	1,557	3	47	10	57	1 16	—	1 16	3
	200	2,000	2,076	3	62	14	76	2 9	—	2 9	3
	500	5,000	5,256	4	210	46	256	8 4	18	7 6	3½
	1,000	10,000	10,650	5	533	117	650	20 16	3 2	17 14	4¼
	2,000	20,000	21,580	6	1,295	285	1,580	50 11	7 12	42 19	5¼
	5,000	50,000	54,669	7	3,827	842	4,669	149 8	22 8	127 0	6
	10,000	100,000	113,895	10	11,389	2,506	13,895	444 13	66 14	377 19	9
	20,000	200,000	234,302	12	28,116	6,186	34,302	1,097 13	164 13	933 0	11¼
	50,000	500,000	640,697	18	115,325	25,372	140,697	4,502 6	675 7	3,826 19	1 6¼
						15 %					
1923-24	100	1,000	1,036	3	31	5	36	1 3	—	1 3	2¾
	150	1,500	1,554	3	47	7	54	1 15	—	1 15	2¾
	200	2,000	2,071	3	62	9	71	2 5	—	2 5	2¾
	500	5,000	5,241	4	210	31	241	7 14	17	6 17	3¼
	1,000	10,000	10,610	5	530	80	610	19 10	2 4	17 6	4¼
	2,000	20,000	21,751	7	1,523	228	1,751	56 1	6 6	49 15	6
	5,000	50,000	57,242	11	6,297	945	7,242	231 15	26 1	205 14	9¼
	10,000	100,000	120,846	15	18,127	2,719	20,846	667 1	75 1	592 0	1 2¼
	20,000	200,000	263,678	21	55,372	8,306	63,678	2,037 14	229 5	1,808 9	1 9¾
	50,000	500,000	725,163	27	195,794	29,369	225,163	7,205 4	810 12	6,394 12	2 6¾
						12½ %					
1925-26	100	1,000	1,035	3	31	4	35	1 2	—	1 2	2¾
	150	1,500	1,553	3	47	6	53	1 14	—	1 14	2¾
	200	2,000	2,070	3	62	8	70	2 5	—	2 5	2¾
	500	5,000	5,235	4	209	26	235	7 10	15	6 15	3¼
	1,000	10,000	10,596	5	530	66	596	19 1	1 18	17 3	4
	2,000	20,000	22,253	9	2,003	250	2,253	72 2	7 4	64 18	7¾
	5,000	50,000	60,976	16	9,756	1,220	10,976	351 5	35 2	316 3	1 5¼
	10,000	100,000	130,933	21	27,496	3,437	30,933	989 17	99 0	890 17	1 9½
	25,000	200,000	278,281	25	69,562	8,696	78,281	2,504 7	250 9	2,253 18	2 3
	50,000	500,000	729,927	28	204,380	25,547	229,927	7,357 13	735 15	6,621 18	2 7¾

* Including Super-tax allowance.

N.B.—For 1918-19, 1923-24 and 1925-26 the policies are regarded as taken out after 22nd June, 1918.

235. The first table has the advantage of illustrating the heavy burden of the duties on big estates, where all the money is invested and the taxpayer has no earned income. In the highest ranges, however, at least in 1923-24 and 1925-26, it gives no indication as to what the taxpayer enjoying the property will himself suffer, for the burden becomes so heavy in conjunction with other taxation that the taxpayer would not (and in the extreme case could not) shoulder it all.

236. The second table shows, all through, a burden which the taxpayer could take upon himself without being superhuman, and probably gives a much truer picture of the burden which really falls on him. Moreover, the case where the income is partly earned is more usual than the case where it is all from invested wealth. We therefore adopt the net insurance premium figures from the second table when collating the various taxes in the general table in paragraph 255.

237. We should add that the insurance method of calculation may possibly be criticised on the ground that an insurance premium covers expenses and contains an element of profit to the company, and cannot therefore be taken as the pure equivalent of a tax. To this we should reply that it would be possible to make some calculation excluding the expense and profit elements, but that we should have two objections to such a course :—

(1) the result would be further away from actuality, since payment of insurance premiums is a method of providing for death duties open to everyone, while the pure tax payments would be quite imaginary :

(2) a refinement of the kind suggested would be inappropriate and misleading, in view of the fact that it is only possible to give a broad picture of the burden of the duties in relation to income.

Inhabited House Duty.

238. The Inhabited House Duty was abolished by the Finance Act, 1924. The figures for 1923-24 and earlier years are generally insignificant, as compared with those of the Income Tax and death duties, but are of some importance in relation to the smaller incomes. We have adopted Sir Herbert Samuel's figures for 1903-04, 1913-14, and 1918-19, which are based, roughly speaking, on an estimate of the ranges of annual value for the houses normally occupied by individuals with such and such incomes. For 1923-24 we have modified the figures in the light of the altered scale which was operative under the Finance Act, 1923. While the relation between the size of a person's income

and the scale of his establishment may of course vary considerably, there is sufficient connection between the two to make reasonably representative figures possible. Our figures are included in the general table in paragraph 255 and need not be set down here.

CUSTOMS AND EXCISE DUTIES.

239. The Customs and Excise duties, unlike the death duties, lay a periodic burden on the individual taxpayer, and there is not the same logical difficulty in the notion of expressing them as a burden of so much in the pound on an income of such and such a size. The practical difficulties, however, are very great, for the reason that the amount of taxation borne by particular individuals depends on their consumption of dutiable goods, which varies to a large extent independently of the amount of income. In the case of tea and sugar, which are articles of almost universal consumption in this country, the variation is probably not very wide; on the other hand, in the case of tobacco and alcoholic drinks, which yield by far the greatest part of the Customs and Excise revenue, it is obvious that consumption varies, at any given level of income, between complete abstention and excess.

240. *Duties on tea, sugar and other foodstuffs.*—Sample budgets of household expenditure here afford a certain amount of useful guidance. In 1904 the Board of Trade collected 1,944 budgets from towns distributed throughout the United Kingdom, and in 1908 the Board of Inland Revenue, which at that date still administered the Excise, collected particulars relating to 225 working class families in rural districts. In 1918 Lord Sumner's Committee on the Cost of Living of the Working Classes collected statistics relating to 1,306 families, but the figures of consumption were not directly related to wages. As a general guide the budgets of 1904 remain the most satisfactory in spite of the lapse of time, the working classes being markedly conservative in their habits of expenditure on the more necessary foods. The year 1918 was entirely abnormal, and subsequent years have not been settled enough to make it likely that a sample would have yielded satisfactory results.

In regard to the duty borne on moderate incomes we derived some guidance from statistics based on the household expenditure in 1921 of families, numbering between 600 and 700, with incomes ranging between £300 and £1,500. These statistics were supplied to us confidentially; they were unlike those referred to above, in not being provided by a Government body or based on Government records.

241. *Duties on tobacco and alcoholic drinks.*—The Board of Trade budgets of 1904 do not cover expenditure in these directions, nor do the Sumner Committee statistics of 1918 Some

information was contained in the results of the Excise enquiry of 1908, but the number of families concerned was too small to yield evidence of any real value. It is exceedingly difficult to obtain reliable information from the consumer of tobacco and alcohol, who is inclined, not unnaturally, to resent enquiry. Probably the most successful investigation was that in regard to alcohol undertaken by Mr. Joseph Rowntree and Mr. Arthur Sherwell in 1898 for their book "The Temperance Problem and Social Reform." The investigation extended to over 10,000 households, and, as Sir Herbert Samuel notes, one of the conclusions it led to was that the average working-class family spent not less than 6s. a week on alcoholic liquor out of an average wage of 35s. This result was the starting-point of certain enquiries made by Sir Bernard Mallet in 1902 and 1904, which distinguished the duty payable by the working-class family, by the lower middle-class family and by the family of the Income Tax paying class. Sir Bernard Mallet's conclusions were adopted by Sir Herbert Samuel, who further differentiated his figures so as to apply to the various incomes on his scale. Sir Herbert worked forward from 1903-04 to 1913-14 and 1918-19 by reference to the comparative revenue—total and per head—of those years.

In the case of tobacco he developed his figures from an estimate for 1914-15, working backwards to 1903-04 and forwards to 1918-19.

242. It will be clear that figures relating to the duties on tobacco and alcohol must be very conjectural, and that there is no foundation on which to build, comparable with that provided for tea and sugar by the Board of Trade budgets of 1904. In the circumstances we decided to attempt independent estimates for the years 1923-24 and 1925-26, and to work backwards to the earlier years. We have been much assisted by the confidential advice and suggestions of several individuals. In addition we were enabled by the courtesy of the Council and the Annual Meeting of the National Co-operative Men's Guild to obtain a number of returns of personal consumption and expenditure from members of the Guild. Forms were issued in October, 1925, to about 2,000 individuals, and yielded 319 returns, falling into the following classes—

Non-smokers and non-drinkers ...	51
Non-smokers but drinkers	11
Non-drinkers but smokers	136
Smokers and drinkers	121

The sample was too small for the resulting figures to be pressed. Further, the proportion of abstainers from tobacco and alcohol was too high, and the consumption of smokers and drinkers too

low, to be generally representative, in view of the known figures of total national consumption : this was notably the case as regards alcohol.

Information regarding tobacco and alcohol was also included in the statistics relating to incomes between £300 and £1,500 mentioned in paragraph 240. Here again the figures were too low to be acceptable as a standard, but both in this case and in the case of the Co-operative returns the figures have been of incidental utility.

243. We may now proceed to deal with the several duties. In the case of the duties on food and also on patent medicines and table waters, we will in the present context set down only the results at which we have arrived. With certain modifications we have founded our calculations on those of Sir Herbert Samuel, and details of our workings may be found in Appendix X.

It should be borne in mind throughout that our estimates relate to the family of two adults and three children under 16 (*see para.* 222). *For* 1918-19 *and the later years the* £50 *income is omitted on account of the rise in nominal wages, and allowance is made for the much reduced purchasing power of money.*

The Tea Duty.

Year.	Income.	Consumption.	Duty.
	£	lbs.	£ s. d.
1903-04	50	26	13 0
	100	28½	14 3
	150	30	15 0
	and above.		
1913-14	50	29½	12 3
	100	32	13 4
	150	34	14 2
	and above.		
1918-19	100	28	1 8 0
	150	32	1 12 0
	200	35	1 15 0
	and above.		
1923-24	100	37	1 1 0
	150	40	1 2 8
	200	42½	1 4 0
	and above.		
1925-26	100	39	11 0
	150	42½	12 0
	200	45	12 9
	and above.		

The Duty on Sugar, etc.
(Including molasses, glucose and saccharin.)

Year.	Income.	Consumption.	Duty.
	£	lbs. (sugar).	£ s. d.
1903–04	50	302	12 0
	100	357	14 0
	150	370	14 6
	200 and above.	383	15 0
1913–14	50	346	6 2
	100	407	7 2
	150	428	7 6
	200 and above.	438	7 8
1918–19	100	206	2 14 0
	150	235	3 1 0
	200	250	3 5 6
	500 and above.	255	3 6 6
1923–24	100	300	3 10 0
	150	355	4 3 0
	200	378	4 8 0
	500 and above.	396	4 12 0
1925–26	100	356	1 17 6
	150	419	2 3 9
	200	434	2 5 3
	500 and above.	456	2 7 6

The Duties on Cocoa, Coffee and Chicory, Dried Fruits, Patent Medicines and Table Waters.

Year.	Income.	Duty.	Year.	Income.	Duty.
	£	s. d.		£	s. d.
1903–04	50	1 0	1918–19	100	10 0
1913–14	100	2 0		150	11 6
	150	3 0		200	14 0
	200 and above.	4 0		500 and above.	15 0

Year.	Income.	Duty.	Year.	Income.	Duty.
	£	s. d.		£	s. d.
1923–24	100	8 3	1925–26	100	6 0
	150	9 0		150	6 6
	200	9 9		200 and above.	6 9
	500 and above.	10 6			

Tobacco Duty.

244. *1923-24 and 1925-26.* (Main rate of duty 8*s.* 2*d.* per lb. subject to preferential rebate of 1/6th in 1923-24, and of 1/4th

after the 1st July, 1925, on Empire products).—As explained in paragraph 242, we here reverse our order, working backwards to earlier years from 1923-24 and 1925-26. Consumption and duty per head were a little higher in the later of these two years, but it does not seem necessary to make any difference in figures for the representative smoker.

We take as our starting-point an estimate given to us in 1925 by a private individual with expert knowledge, who was good enough to collect data for the purpose in the North of England, on the South Coast, and in the London area. The estimate related to the average consumption, &c., for a family man, with £200 per annum, and was as follows, in approximate figures :—

	Quantity per annum.	Cost per annum.			Duty per annum.		
		£	*s.*	*d.*	£	*s.*	*d.*
Pipe smoker	13 lbs.	7	16	0	4	8	10
Cigarette smoker	4160 cigarettes.	10	8	0	4	4	6

4,160 cigarettes may be taken as equivalent to 12 lbs. of cigarette tobacco.

These average figures appear to be reasonable in the light of the total consumption, which was about 129,000,000 lbs. in 1923-24 and 135,000,000 lbs. in 1925-26 (Great Britain and Northern Ireland). We have taken them as a basis for estimates relating to the " representative " smoker at the various points of family income. The consumption of the individual consumer probably does not expand very much with increases of income above £200, but the following points may be noted :—

(*a*) The tobacco smoked by the more well-to-do generally contains less moisture than that smoked by the working man, and therefore bears a higher rate of duty. Moreover, the richer classes would be the consumers of the more highly taxed imported cigars and cigarettes. We have assumed a progressive increase in the average rate from about 6*s.* 6*d.* per lb. in the smallest incomes to about 8*s.* 9*d.* in the largest.

(*b*) An appreciable addition has to be made for the wife's smoking in the families with incomes of £500 and upwards.

(*c*) With regard to the higher incomes, it may be taken that in the representative case the expenditure on entertaining of the richer man (who on the average will also be the older man—*cf. para.* 232) will tend to exceed his consumption at the expense of others. We have allowed a not very great but increasing margin for such " excess entertainment."

(*d*) The duty on matches is included in our figures. The revenue from matches was a little over £3 millions—about 1/16th of that from tobacco.

The figures we conjecture for family incomes are as follows :—

1923-24 and 1925-26.

Income £	*Tobacco Duty (including Duty on Matches).* £ *s.* *d.*
100	2 15 0
150	4 0 0
200	4 15 0
500	5 0 0
1,000	6 15 0
2,000	7 10 0
5,000	9 13 0
10,000 and above	10 4 0

245. *1918-19.* (Main rate of duty 8*s.* 2*d.* per lb. from 23rd April, 1918).—From the above figures we work backwards to 1918-19, taking the following points into consideration :—

(*a*) Total consumption (United Kingdom) in 1918-19 was 114,400,000 lbs. We estimate the per head consumption as about 2·6 lbs., compared with 2·9 lbs. for 1923-24 (say, 9/10ths of 1923-24).

(*b*) In 1918-19 the average cost of living index figure was about 210, and in 1923-24 about 175. This fact tells in favour of putting the representative consumption of the smaller incomes in 1918-19 at less than 9/10ths of their consumption in 1923-24.

(*c*) The revenue from matches was just over £2 millions—about 1/23rd of that from tobacco.

The figures suggested are :—

1918-19.

Income. £	*Tobacco Duty (including Duty on Matches).* £ *s.* *d.*
100	2 5 0
150	3 6 0
200	4 2 0
500	4 9 0
1,000	6 0 0
2,000	6 13 0
5,000	8 3 0
10,000 and upwards	9 0 0

246. *1913-14.* (Main rate of duty 3*s.* 8*d.* per lb.).—Our figures are again worked from those of 1923-24. Duty per head was 8*s.* in the earlier year as compared with £1 3*s.* 3*d.* in the later, but in dealing with incomes of fixed nominal amount allowance has to be made for the much higher pre-war value of money and also (in the larger incomes) for the smaller inroads of Income Tax into spendable income. Further, it is probable that the proportion of smokers to non-smokers was lower in 1913-14 (*cf. para.* 635).

The figures suggested are :—

1913-14.

Income. £	*Duty.* £ *s.* *d.*
50	1 1 0
100	1 10 0
150	1 15 0
200	1 17 0
500	2 10 0
1,000	2 15 0
2,000	3 5 0
5,000 and above	3 15 0

247. *1903-04.* (Main rate of duty 3*s.* per lb.).—The figures for this year may be worked from those for 1913-14. The duty on the cheapest tobacco, as sold retail, was about 2*s.* 9*d.* in 1903-04 and 3*s.* 4*d.* in 1913-14. Consumption per head was as 9 to 10, duty per head was therefore practically as 3 to 4. Taking this ratio we get :—

1903-04.

Income £	*Duty.* £ *s.* *d.*
50	0 16 0
100	1 2 0
150	1 6 0
200	1 8 0
500	1 18 0
1,000	2 1 0
2,000	2 9 0
5,000 and above	2 16 0

Duty on Alcoholic Drinks.

248. *1923-24.*—In the absence of any reliable evidence as to representative consumption at the specified levels of income, we have fallen back on certain known data (for Great Britain only), viz., the total consumption of spirits, beer and wine, with the duty on each, and the approximate numbers of the adult population (over 18), male and female. Then, by a series of calculations we have arrived at certain alternative estimates of *average* consumption and duty for the male and the female consumer in three different income groups :—

Group A (incomes upwards of £500).
Group B (incomes between £200 and £500).
Group C (incomes up to £200).

These average figures for three groups have given us a certain guidance in framing estimates of *representative* consumption and duty for each of the family incomes in our scale.

249. The calculations of average consumption and duty are given in Appendix X. In working from the figures of adult population, we have taken two alternative hypotheses as to the proportion of abstainers, male and female, in each income group.

In Hypothesis I we have assumed that in each group 15 per cent. of the males and 40 per cent. of the females are abstainers, or practically so; we have also assumed, for spirits, beer and wine separately, certain proportions between the average consumption of male and female. We have then taken four sub-hypotheses as to the ratio, for each class of drink, between the average consumption of the male in Group A and that of the males in Group B and Group C. We are thus enabled to give four alternative sets of figures, representing the average per head duty on spirits, beer and wine borne by the male and female consumer in each income group.

In Hypothesis II we have taken a proportion of abstainers varying according to the group :—

	Proportion of Abstainers.	
	Male.	*Female.*
	Per cent.	*Per cent.*
Group A (incomes upwards of £500)...	15	30
Group B (between £200 and £500) ...	20	45
Group C (up to £200)	10	20

We have then applied the same alternative sub-hypotheses as before.

250. The figures of per head duty resulting from the four sub-divisions of Hypotheses I and II are brought together for comparison in the final table in Appendix X. After adducing certain practical and statistical considerations, we take as average figures of alcohol duty for a male and female consumer together—

	£	*s.*
Group A	20	0
Group B	12	0
Group C	10	10

From these average figures, and from the tables of consumption and duty on which they are based, we work, on certain assumptions, to representative figures for 10 different family incomes. The figures of duty which result (admittedly highly speculative) are as follows :—

1923-24.

Income.	Duty (on consumption of husband and wife).									Total Duty, say
	Spirits.			Beer.			Wine.			
£	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£
100	—			6	2	0	—			6
150	2	6	6	7	10	0		3	0	10
200	3	3	5	8	8	9		8	0	12
500	6	6	10	3	12	11	1	17	6	12
1,000	10	11	5	2	6	10	5	0	0	18
2,000	19	0	6	1	11	3	7	10	0	28
5,000	25	7	6		18	9	23	6	8	50
10,000 and above	38	1	3		18	9	60	0	0	100

251. From these figures we work forward to 1925-26, and backward to 1918-19, 1913-14 and 1903-04, in the light of such data as are available. The following are the immediate pre-war figures of duty we are led to suggest :—

1913-14.

Income.	Duty (on consumption of husband and wife).									Total Duty, say		
	Spirits.			Beer.			Wine.					
£	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
50		17	7	1	0	10		1	4	2	0	0
100	1	9	4	1	2	11		2	8	2	15	0
150	1	15	3	1	5	0		5	4	3	5	0
200	2	3	1	1	5	0		10	0	4	0	0
500	2	18	9		7	4	1	13	4	5	0	0
1000	4	17	11		3	8	2	10	0	7	10	0
2000	6	17	1		2	7	6	10	0	13	10	0
5000 and above	9	15	10		2	7	17	10	0	27	10	0

Fuller details, and workings for other years, are given in Appendix X.

252. It may be noted that for 1903-04 and 1913-14 our figures differ greatly from those of Sir Herbert Samuel, so far as incomes of £500 and £1,000 (and to a less extent £2,000) are concerned. Sir Herbert's figures for Income Tax paying families were based on an average duty figure of £14 3s. 3½d. per family, which had been calculated by Sir Bernard Mallet in 1904. When the low rates of duty prevailing in 1903-04 are considered, this average figure implies far too heavy a consumption to be credible. For the higher incomes the difference between our figures and those of Sir Herbert Samuel is less; indeed from the income of £5,000 onwards they are very close, but this is only because, in our calculations, we have made a generous allowance for "excess entertainment" (*see Appendix* X).

For 1918-19, mainly owing to the allowance which we have made for the altered purchasing power of money, the difference in our figures from those of Sir Herbert Samuel becomes still wider. There is a similarly increased difference under the head of tobacco.

Entertainments Duty.

253. In the case of this duty allocation to different levels of income is eminently a matter of conjecture. The following figures are hazarded for *1918-19* and *1923-24*.

Income.	*Duty.*	
	1918-19.	*1923-24.*
£	*s.* *d.*	*s.* *d.*
100	5 6	7 6
150	7 0	9 0
200	7 6	10 0
500	11 6	14 0
1,000	17 0	20 0
2,000	30 0	32 0
5,000	40 0	45 0
10,000 and above ...	50 0	55 0

The figures for the small incomes are put rather low; it is suggested that a man and wife and three young children would usually spend less than the normal household of five (*cf. para.* 222).

254. *1925-26.*—The yield was £5,714,000 as compared with £9,285,000 in 1923-24. The Finance Act, 1924, abolished duty on payments of 6d. and under, and reduced the scale of duty on payments up to 1s 3d. The burden on small incomes has thus been very much reduced, and we take the following figures :—

Income.	*Duty.*
£	*s.*
100	3
150	4
200	5
500	12

There does not appear to be any reason for altering the 1923-24 figures in the case of the larger incomes.

THE TOTAL BURDEN OF TAXATION.

255. We now gather into one table our figures for the several duties, direct and indirect. It will be borne in mind that the figures other than those for the Income Tax are in various degrees speculative, and have no official authority. In particular, the figures for the following duties attempt to illustrate rather than to measure liability :—

Death Duties.
Duty on Tobacco.
Duty on Alcoholic Drinks.
Entertainments Duty.

In regard to these duties it may be observed that the individual can, if he chooses, ignore the prospective burden of the death duties; if he is a non-smoker and non-drinker, he escapes the duties on tobacco and alcohol; again the burden of the Entertainments Duty depends on voluntary expenditure. All these duties then differ from the Income Tax and Super-tax, which are inevitable burdens on incomes above certain limits, and from the duties on tea, sugar, etc., which may also be regarded as inevitable burdens, since they fall on commodities almost universally consumed. In view of these considerations it may be of interest to add a second table, excluding the death duties, and the duties on tobacco, alcoholic drinks and entertainments.

GENERAL

Relating Direct and Indirect

N.B.—The Taxpayer is assumed to be married

Income.	Income Tax and Super-tax.		Death Duties.	Inhabited House Duty.	Total Direct Taxes.		Tea.	Sugar.	Tobacco.
	Income wholly earned.	Income half earned half investment.	Income half earned half investment.		Income wholly earned.	Income half earned half investment.			
1903/04.	£ s. d.	£ s. d.	£ s. d.	£ s. d	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
50	—	—	8 0	—	—	8 0	13 0	12 0	16 0
100	—	—	1 5 0	—	—	1 5 0	14 3	14 0	2 0
150	—	—	1 18 0	4 6	4 6	2 2 6	15 0	14 6	1 6 0
200	1 16 8	1 16 8	2 9 0	7 6	2 4 2	4 13 2	15 0	15 0	1 8 0
500	16 0 10	16 0 10	6 1 0	1 5 0	17 5 10	23 6 10	15 0	15 0	1 18 0
1,000	45 16 8	45 16 8	16 6 0	3 0 0	48 16 8	65 2 8	15 0	15 0	2 1 0
2,000	91 13 4	91 13 4	32 14 0	4 15 0	96 8 4	129 2 4	15 0	15 0	2 9 0
5,000	229 3 4	229 3 4	103 11 0	9 0 0	238 3 4	341 14 4	15 0	15 0	2 16 0
10,000	458 6 8	458 6 8	251 17 0	15 0 0	473 6 8	725 3 8	15 0	15 0	2 16 0
20,000	916 13 4	916 13 4	549 9 0	28 0 0	944 13 4	1,494 2 4	15 0	15 0	2 16 0
50,000	2,291 13 4	2,291 13 4	1,607 5 0	55 0 0	2,346 13 4	3,953 18 4	15 0	15 0	2 16 0
1913/14.									
50	—	—	8 0	—	—	8 0	12 3	6 2	1 1 0
100	—	—	1 5 0	—	—	1 5 0	13 4	7 2	1 10 0
150	—	—	1 18 0	4 6	4 6	2 2 6	14 2	7 6	1 15 0
200	7 6	11 8	2 8 0	7 6	15 0	3 7 2	14 2	7 8	1 17 0
500	12 0 0	17 4 2	8 3 0	1 5 0	13 5 0	28 12 2	14 2	7 8	2 10 0
1,000	37 10 0	47 18 4	20 10 0	3 0 0	40 10 0	71 8 4	14 2	7 8	2 15 0
2,000	75 0 0	95 16 8	49 19 0	4 15 0	79 15 0	150 10 8	14 2	7 8	3 5 0
5,000	291 13 4	291 13 4	144 10 0	9 0 0	300 13 4	445 3 4	14 2	7 8	3 15 0
10,000	758 6 8	758 6 8	371 17 0	15 0 0	773 6 8	1,145 3 8	14 2	7 8	3 15 0
20,000	1,591 13 4	1,591 13 4	935 5 0	28 0 0	1,619 13 4	2,554 18 4	14 2	7 8	3 15 0
50,000	4,091 13 4	4,091 13 4	2,588 4 0	55 0 0	4,146 13 4	6,734 17 4	14 2	7 8	3 15 0
1918/19.									
100	—	—	1 4 0	—	—	1 4 0	1 8 0	2 14 0	2 5 0
150	—	—	1 16 0	4 6	4 6	2 0 6	1 12 0	3 1 0	3 6 0
200	—	—	2 9 0	7 6	7 6	2 16 6	1 15 0	3 5 6	4 2 0
500	33 15 0	43 2 6	7 6 0	1 5 0	35 0 0	51 13 6	1 15 0	3 6 6	4 9 0
1,000	146 5 0	165 0 0	17 14 0	3 0 0	149 5 0	185 14 0	1 15 0	3 6 6	6 0 0
2,000	450 0 0	487 10 0	42 19 0	4 15 0	454 15 0	535 4 0	1 15 0	3 6 6	6 13 0
5,000	1,787 10 0	1,787 10 0	127 0 0	9 0 0	1,796 10 0	1,923 10 0	1 15 0	3 6 6	8 3 0
10,000	4,187 10 0	4,187 10 0	377 19 0	15 0 0	4,202 10 0	4,580 9 0	1 15 0	3 6 6	9 0 0
20,000	9,437 10 0	9,437 10 0	933 0 0	28 0 0	9,465 10 0	10,398.10 0	1 15 0	3 6 6	9 0 0
50,000	25,187 10 0	25,187 10 0	3,826 19 0	55 0 0	25,242 10 0	29,069 9 0	1 15 0	3 6 6	9 0 0
1923/24.									
100	—	—	1 3 0	—	—	1 3 0	1 1 0	3 10 0	2 15 0
150	—	—	1 15 0	—	—	1 15 0	1 2 8	4 3 0	4 0 0
200	—	—	2 5 0	5 0	5 0	2 10 0	1 4 0	4 8 0	4 15 0
500	15 3 9	18 0 0	6 17 0	12 6	15 16 3	25 9 6	1 4 0	4 12 0	5 0 0
1,000	108 6 3	117 11 3	17 6 0	2 10 0	108 16 3	137 7 3	1 4 0	4 12 0	6 15 0
2,000	308 16 3	331 6 3	49 15 0	4 15 0	313 11 3	385 16 3	1 4 0	4 12 0	7 10 0
5,000	1,346 6 3	1,346 6 3	205 14 0	9 0 0	1,355 6 3	1,561 0 3	1 4 0	4 12 0	9 13 0
10,000	3,571 6 3	3,571 6 3	592 0 0	15 0 0	3,586 6 3	4,178 6 3	1 4 0	4 12 0	10 4 0
20,000	8,321 6 3	8,321 6 3	1,808 9 0	28 0 0	8,349 6 3	10,157 15 3	1 4 0	4 12 0	10 4 0
50,000	23,821 6 3	23,821 6 3	6,394 12 0	55 0 0	23,876 6 3	30 270 18 3	1 4 0	4 12 0	10 4 0
1925/26.									
100	—	—	1 2 0		—	1 2 0	11 0	1 17 6	2 15 0
150	—	—	1 14 0		—	1 14 0	12 0	2 3 9	4 0 0
200	—	—	2 5 0		—	2 5 0	12 8	2 5 3	4 15 0
500	10 3 4	14 6 8	6 15 0		10 3 4	21 1 8	12 9	2 7 6	5 0 0
1,000	81 3 4	97 16 8	17 3 0		81 3 4	114 19 8	12 9	2 7 6	6 15 0
2,000	264 10 0	281 3 4	64 18 0		264 10 0	346 1 4	12 9	2 7 6	7 10 0
5,000	1,095 15 0	1,095 15 0	316 3 0		1,095 15 0	1,411 18 0	12 9	2 7 6	9 13 0
10,000	2,995 15 0	2,995 15 0	890 17 0		2,995 15 0	3,886 12 0	12 9	2 7 6	10 4 0
20,000	7,370 15 0	7,370 15 0	2,253 18 0		7,370 15 0	9,624 13 0	12 9	2 7 6	10 4 0
50,000	22,120 15 0	22,120 15 0	6,621 18 0		22,120 15 0	28,742 13 0	12 9	2 7 6	10 4 0

Inhabited House Duty abolished by Finance Act, 1924.

TABLE I.

Taxation to Specimen Incomes.

and to have 3 children under the age of 16.

Alcoholic Drinks.	Entertainments.	Cocoa, Coffee and Chicory, Dried Fruits, Patent Medicines and Table Waters.	Total Indirect Taxes.	Total Taxation.		Total Taxation: Percentage of Income.					
				Income wholly earned.	Income half earned half investment.	Income wholly earned.			Income half earned half investment.		
						Direct.	Indirect.	Total.	Direct.	Indirect.	Total.
£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	%	%	%	%	%	%
2 5 0	—	1 0	4 7 0	4 7 0	4 15 0	—	8·7	8·7	0·8	8·7	9·5
3 0 0	—	2 0	5 12 3	6 17 3	—	5·6	5·6	1·2	5·6	6·8	
3 10 0	—	3 0	6 8 6	6 13 0	8 11 0	0·2	4·3	4·5	1·4	4·3	5·7
4 5 0	—	4 0	7 7 0	9 11 2	12 0 2	1·1	3·7	4·8	2·3	3·7	6·0
5 5 0	—	4 0	8 17 0	26 2 10	32 3 10	3·5	1·8	5·3	4·7	1·8	6·5
8 0 0	—	4 0	11 15 0	60 11 8	76 17 8	4·9	1·2	6·1	6·6	1·2	7·8
14 10 0	—	4 0	18 13 0	115 1 4	147 15 4	4·8	0·9	5·7	6·5	0·9	7·4
29 0 0	—	4 0	33 10 0	271 13 4	375 4 4	4·8	0·7	5·5	6·8	0·7	7·5
29 0 0	—	4 0	33 10 0	506 16 8	758 13 8	4·7	0·3	5·0	7·3	0·3	7·6
29 0 0	—	4 0	33 10 0	978 3 4	1,527 12 4	4·7	0·2	4·9	7·5	0·2	7·7
29 0 0	—	4 0	33 10 0	2,380 3 4	3,987 8 4	4·7	0·1	4·8	7·9	0·1	8·0
2 0 0	—	1 0	4 0 5	4 0 5	4 8 5	—	8·0	8·0	0·8	8·0	8·8
2 15 0	—	2 0	5 7 6	5 7 6	6 12 6	—	5·4	5·4	1·2	5·4	6·6
3 5 0	—	3 0	6 4 8	6 9 2	8 7 2	0·2	4·2	4·4	1·4	4·2	5·6
4 0 0	—	4 0	7 2 10	7 17 10	10 10 0	0·4	3·6	4·0	1·7	3·6	5·3
5 0 0	—	4 0	8 15 10	22 0 10	35 8 0	2·6	1·8	4·4	5·3	1·8	7·1
7 10 0	—	4 0	11 10 10	52 0 10	82 19 2	4·0	1·2	5·2	7·1	1·2	8·3
13 10 0	—	4 0	18 0 10	97 15 10	168 11 6	4·0	0·9	4·9	7·5	0·9	8·4
27 10 0	—	4 0	32 10 10	333 4 2	477 14 2	6·0	0·7	6·7	8·9	0·7	9·6
27 10 0	—	4 0	32 10 10	805 17 6	1,177 14 6	7·7	0·3	8·0	11·5	0·3	11·8
27 10 0	—	4 0	32 10 10	1,652 4 2	2,587 9 2	8·1	0·2	8·3	12·8	0·2	13·0
27 10 0	—	4 0	32 10 10	4,179 4 2	6,767 8 2	8·3	0·1	8·4	13·5	0·1	13·6
2 15 0	5 6	10 0	9 17 6	9 17 6	11 1 6	—	9·9	9·9	1·2	9·9	11·1
4 5 0	7 0	11 6	13 2 6	13 7 0	15 3 0	0·2	8·8	9·0	1·4	8·8	10·2
5 5 0	7 6	14 0	15 9 0	15 16 6	18 5 6	0·2	7·7	7·9	1·4	7·7	9·1
6 0 0	11 8	15 0	15 17 0	50 17 0	67 10 6	7·0	3·2	10·2	10·3	3·2	13·5
7 10 0	17 0	15 0	20 3 6	169 8 6	205 17 6	14·9	2·0	16·9	18·6	2·0	20·6
11 15 0	1 10 0	15 0	25 14 6	480 9 6	560 18 6	22·7	1·3	24·0	26·8	1·3	28·1
20 0 0	2 0 0	15 0	35 19 6	1,832 9 6	1,959 9 6	35·9	0·7	36·6	38·5	0·7	39·2
36 0 0	2 10 0	15 0	53 6 6	4,255 16 6	4 633 15 6	42·0	0·5	42·5	45·8	0·5	46·3
36 0 0	2 10 0	15 0	53 6 6	9,518 16 6	10,451 16 6	47·3	0·3	47·6	52·0	0·3	52·3
36 0 0	2 10 0	15 0	53 6 6	25,295 16 6	29,122 15 6	50·5	0·1	50·6	58·1	0·1	58·2
6 0 0	7 6	8 3	14 1 9	14 1 9	15 4 9	—	14·1	14·1	1·2	14·1	15·3
10 0 0	9 0	9 0	20 3 8	20 3 8	21 18 8	—	13·5	13·5	1·2	13·5	14·7
12 0 0	10 0	9 9	23 6 9	23 11 9	25 16 9	0·1	11·7	11·8	1·2	11·7	12·9
12 0 0	14 0	10 6	24 0 6	39 16 9	49 10 0	3·2	4·8	8·0	5·1	4·8	9·9
18 0 0	1 0 0	10 6	32 1 6	140 17 9	169 8 9	10·9	3·2	14·1	13·7	3·2	16·9
28 0 0	1 12 0	10 6	43 8 6	358 19 9	429 4 9	15·7	2·2	17·9	19·3	2·2	21·5
50 0 0	2 5 0	10 6	68 4 6	1,423 10 9	1,629 4 9	27·1	1·4	28·5	31·2	1·4	32·8
100 0 0	2 15 0	10 6	119 5 6	3,705 11 9	4,297 11 9	35·9	1·2	37·1	41·8	1·2	43·0
100 0 0	2 15 0	10 6	119 5 6	8,488 11 9	10,277 0 9	41·7	0·6	42·3	50·8	0·6	51·4
100 0 0	2 15 0	10 6	119 5 6	23,995 11 9	30,390 3 9	47·8	0·2	48·0	60·5	0·2	60·7
6 5 0	3 0	6 0	11 17 6	11 17 6	12 19 6	—	11·9	11·9	1·1	11·9	13·0
10 3 0	4 0	6 6	17 9 3	17 9 3	19 3 3	—	11·6	11·6	1·1	11·6	12·7
12 3 0	5 0	6 9	20 7 9	20 7 9	22 12 9	—	10·2	10·2	1·1	10·2	11·3
12 0 0	12 0	6 9	20 19 0	31 2 4	42 0 8	2·0	4·2	6·2	4·2	4·2	8·4
18 0 0	1 0 0	6 9	29 2 0	110 5 4	144 1 8	8·1	2·9	11·0	11·5	2·9	14·4
28 0 0	1 12 0	6 9	40 9 0	304 19 0	386 10 4	13·2	2·0	15·2	17·3	2·0	19·3
50 0 0	2 5 0	6 9	65 5 0	1,161 0 0	1,477 3 0	21·9	1·3	23·2	28·2	1·3	29·5
105 0 0	2 15 0	6 9	121 6 0	3,117 1 0	4,007 18 0	30·0	1·2	31·2	38·9	1·2	40·1
105 0 0	2 15 0	6 9	121 6 0	7,492 1 0	9,745 19 0	36·9	0·6	37·5	48·1	0·6	48·7
105 0 0	2 15 0	6 9	121 6 0	22,242 1 0	28,863 19 0	44·2	0·2	44.4	57·5	0·2	57·7

General Table II.

Relating Direct and Indirect Taxation—but with the exclusion of the Death Duties, the Duties on Tobacco and on Alcoholic Drinks, and the Entertainments Duty—to Specimen Incomes.

N.B.—The Taxpayer is assumed to be married and to have 3 children under the age of 16.

Income	Income Tax and Super-tax.		Inhabited House Duty.	Tea.	Sugar.	Cocoa, Coffee and Chicory, Dried Fruits, Patent Medicines and Table Waters.	Total Taxation.		Total Taxation: Percentage of Income.	
	Income wholly Earned.	Income Half Earned Half Investment.					Income wholly Earned.	Income Half Earned Half Investment.	Income wholly Earned	Income Half Earned Half Investment
1903/04	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	%	%
50	—	—	—	0 13 0	0 12 0	0 1 0	1 6 0	1 6 0	2·6	2·6
100	—	—	—	0 14 3	0 14 0	0 2 0	1 10 3	1 10 3	1·5	1·5
150	—	—	0 4 6	0 15 0	0 14 6	0 3 0	1 17 0	1 17 0	1·2	1·2
200	1 16 8	1 16 8	0 7 6	0 15 0	0 15 0	0 4 0	3 18 2	3 18 2	2·0	2·0
500	16 0 10	16 0 10	1 5 0	0 15 0	0 15 0	0 4 0	18 19 10	18 19 10	3·8	3·8
1,000	45 16 8	45 16 8	3 0 0	0 15 0	0 15 0	0 4 0	50 10 8	50 10 8	5·1	5·1
2,000	91 13 4	91 13 4	4 15 0	0 15 0	0 15 0	0 4 0	98 2 4	98 2 4	4·9	4·9
5,000	229 3 4	229 3 4	9 0 0	0 15 0	0 15 0	0 4 0	239 17 4	239 17 4	4·8	4·8
10,000	458 6 8	458 6 8	15 0 0	0 15 0	0 15 0	0 4 0	475 0 8	475 0 8	4·8	4·8
20,000	916 13 4	916 13 4	28 0 0	0 15 0	0 15 0	0 4 0	946 7 4	946 7 4	4·7	4·7
50,000	2,291 13 4	2,291 13 4	55 0 0	0 15 0	0 15 0	0 4 0	2,348 7 4	2,348 7 4	4·7	4·7
1913/14										
50	—	—	—	0 12 3	0 6 2	0 1 0	0 19 5	0 19 5	1·9	1·9
100	—	—	—	0 13 4	0 7 2	0 2 0	1 2 6	1 2 6	1·1	1·1
150	—	—	0 4 6	0 14 2	0 7 6	0 3 0	1 9 2	1 9 2	1·0	1·0
200	0 7 6	0 11 8	0 7 6	0 14 2	0 7 8	0 4 0	2 0 10	2 5 0	1·0	1·1
500	12 0 0	17 4 2	1 5 0	0 14 2	0 7 8	0 4 0	14 10 10	19 15 0	2·9	4·0
1,000	37 10 0	47 18 4	3 0 0	0 14 2	0 7 8	0 4 0	41 15 10	52 4 2	4·2	5·2
2,000	75 0 0	95 16 8	4 15 0	0 14 2	0 7 8	0 4 0	81 0 10	101 17 6	4·1	5·1
5,000	291 13 4	291 13 4	9 0 0	0 14 2	0 7 8	0 4 0	301 19 2	301 19 2	6·0	6·0
10,000	758 6 8	758 6 8	15 0 0	0 14 2	0 7 8	0 4 0	774 12 6	774 12 6	7·7	7·7
20,000	1,591 13 4	1,591 13 4	28 0 0	0 14 2	0 7 8	0 4 0	1,620 19 2	1,620 19 2	8·1	8·1
50,000	4,091 13 4	4,091 13 4	55 0 0	0 14 2	0 7 8	0 4 0	4,147 19 2	4,147 19 2	8·3	8·3
1918/19										
100	—	—	—	1 8 0	2 14 0	0 10 0	4 12 0	4 12 0	4·6	4·6
150	—	—	0 4 6	1 12 0	3 1 0	0 11 6	5 9 0	5 9 0	3·6	3·6
200	—	—	0 7 6	1 15 0	3 5 6	0 14 0	6 2 0	6 2 0	3·0	3·0
500	33 15 0	43 2 6	1 5 0	1 15 0	3 6 6	0 15 0	40 16 6	50 4 0	8·2	10·0
1,000	146 5 0	165 0 0	3 0 0	1 15 0	3 6 6	0 15 0	155 1 6	178 16 6	15·5	17·4
2,000	450 0 0	487 10 0	4 15 0	1 15 0	3 6 6	0 15 0	460 11 6	498 1 6	23·0	24·9
5,000	1,787 10 0	1,787 10 0	9 0 0	1 15 0	3 6 6	0 15 0	1,802 6 6	1,802 6 6	36·0	36·0
10,000	4,187 10 0	4,187 10 0	15 0 0	1 15 0	3 6 6	0 15 0	4,208 6 6	4,208 6 6	42·1	42·1
20,000	9,437 10 0	9,437 10 0	28 0 0	1 15 0	3 6 6	0 15 0	9,471 6 6	9,471 6 6	47·4	47·4
50,000	25,187 10 0	25,187 10 0	55 0 0	1 15 0	3 6 6	0 15 0	25,248 6 6	25,248 6 6	50·5	50·5
1923/24										
100	—	—	—	1 1 0	3 10 6	0 8 3	4 19 3	4 19 3	5·0	5·0
150	—	—	—	1 2 8	4 3 0	0 9 0	5 14 8	5 14 8	3·8	3·8
200	—	—	0 5 0	1 4 0	4 8 0	0 9 9	6 6 9	6 6 9	3·2	3·2
500	15 3 9	18 0 0	0 12 6	1 4 0	4 12 0	0 10 6	22 2 9	24 19 0	4·4	5·0
1,000	106 6 3	117 11 3	2 10 0	1 4 0	4 12 0	0 10 6	115 2 9	126 7 9	11·5	12·6
2,000	308 16 3	331 6 3	4 15 0	1 4 0	4 12 0	0 10 6	319 17 9	342 7 9	16·0	17·1
5,000	1,846 6 3	1,846 6 3	9 0 0	1 4 0	4 12 0	0 10 6	1,861 12 9	1,861 12 9	27·2	27·2
10,000	3,571 6 3	3,571 6 3	15 0 0	1 4 0	4 12 0	0 10 6	3,592 12 9	3,592 12 9	35·9	35·9
20,000	8,321 6 3	8,321 6 3	28 0 0	1 4 0	4 12 0	0 10 6	8,355 12 9	8,355 12 9	41·8	41·8
50,000	23,821 6 3	23,821 6 3	55 0 0	1 4 0	4 12 0	0 10 6	23,882 12 9	23,882 12 9	47·8	47·8
1925/26										
100	—	—	Inhabited House Duty abolished by Finance Act, 1924.	0 11 0	1 17 6	0 6 0	2 14 6	2 14 6	2·7	2·7
150	—	—		0 12 0	2 3 9	0 6 6	3 2 3	3 2 3	2·1	2·1
200	—	—		0 12 9	2 5 3	0 6 9	3 4 9	3 4 9	1·6	1·6
500	10 3 4	14 6 8		0 12 9	2 7 6	0 6 9	13 10 4	17 13 8	2·7	3·5
1,000	81 3 4	97 16 8		0 12 9	2 7 6	0 6 9	84 10 4	101 3 8	8·5	10·1
2,000	264 10 0	281 3 4		0 12 9	2 7 6	0 6 9	267 17 0	284 10 4	13·4	14·2
5,000	1,095 15 0	1,095 15 0		0 12 9	2 7 6	0 6 9	1,099 2 0	1,099 2 0	22·0	22·0
10,009	2,995 15 0	2,995 15 0		0 12 9	2 7 6	0 6 9	2,999 2 0	2,999 2 0	30·0	30·0
20,000	7,370 15 0	7,370 15 0		0 12 9	2 7 6	0 6 9	7,374 2 0	7,374 2 0	36·9	36·9
50,000	22,120 15 0	22,120 15 0		0 12 9	2 7 6	0 6 9	22,124 2 0	22,124 2 0	44·2	44·2

SECTION IV.

THE INCIDENCE AND EFFECTS OF EXISTING TAXES.

SUB-SECTION I: TAXATION AND EXPENDITURE: THE EXPENDITURE SIDE.

256. Any complete enquiry into the central finances of the country would involve a close examination of the whole of the expenditure side, as well as the revenue side, of the Government accounts. Our enquiry, wide as is it, falls far short of this. On the expenditure side we are particularly concerned only with the service of the National Debt. At the same time it would be impossible to form any just estimate of the effects of existing taxes, without giving some attention to other objects of Government expenditure; for, as Mr. J. A. Hobson expressed it, "the general long-range effects of taxation upon trade largely hinge upon the uses made by the State of the tax revenue." (*E. in C.* : 20.)

257. With a few insignificant exceptions, the existing taxes are not earmarked to any particular items of expenditure. The way in which the revenue is applied has, consequently, effects which may be related to the taxes generally, and not to any part of the system more than to another. For this reason it seems desirable to give some prior consideration to these effects of expenditure, and then to deal separately with the effects of the several taxes.

258. We may slightly vary the classification of expenditure made by Mr. W. T. Layton in his evidence before us, and take the following headings:—

(i) *Service of the External Debt.*
(ii) *Interest on the Internal Debt.*
(iii) *Repayment of Internal Debt.*
(iv) *Pensions.*
(v) *Defence.*
(vi) *Social Expenditure.*
(vii) *Other Services.*

The first three of these headings are our primary concern.

(i) *Service of the External Debt.*

259. In discussing the nature of the external debt (*cf. para.* 71 *et seq.*) we have seen that it involves a very heavy burden, although we do not forget that the resources lent to the country were of the greatest value for the prosecution of the War. Pay-

ment of interest on the present external debt, and repayment of the capital sum, while clearly essential to our credit, have to be made without any tangible return. They do not add to the wealth of the country, nor do they create within the country any new source of saving or purchasing power.

We do not think the external debt exerts any very strong psychological effect. Large and burdensome as it is, it seems to be overshadowed in the popular imagination by the much larger, but in other ways less burdensome, internal debt.

(ii) *Interest on the Internal Debt.*

260. The large proportion of the tax revenue corresponding to interest on the internal debt is redistributed within this country. It adds to the potential saving and purchasing power of the interest receivers what is subtracted from the taxpayers. No one can say exactly what is the effect of the transfer, either on the national savings or on the distribution of wealth. It would be necessary to know the answer to the questions—Who are the taxpayers? Who are the interest receivers? What use would the taxpayers have made of the money? What use, in fact, do the interest receivers make of it?

261. Even if we had exact answers to these questions, the value of the information would in some ways be limited. In the first place, the figures would give no indication of the waste involved in the process of taxation. Not only does the process absorb the services of the persons concerned in the administration and collection of the duties; it also employs a very large amount of time and energy on the part of taxpayers, and of solicitors, accountants and others acting on their behalf. The waste cannot be measured in figures, or apportioned between different classes of people. Any calculations, however, which ignore its existence must to some extent be vitiated.

262. But there is a more important point. The transfer of income from taxpayer to debt-holder is an isolated transaction which must not be taken as giving a full measure of the way in which the War Loan system—borrowing first and taxing afterwards—has affected the distribution of wealth and the national savings. We explain this in paragraphs 268-272.

263. No official statistics are available to show how the internal debt is held. Mr. Layton has, however, made an estimate, the figures of which we may take from his evidence given on the 5th August, 1924 (*E. in C.* : 9 (ii))—

	£ millions.
British Joint Stock Banks and Foreign Banks with offices in London (including an estimate of £100 millions of Treasury Bills)	750
Bank of England	70

	£ millions.
Post Office Savings Bank (£285 millions less £120 millions in guaranteed or other securities not forming part of the dead-weight debt) and Trustee Savings Bank (£80 millions, less £30 millions)	215
Government Securities purchased for depositors through the Savings Banks (£210 millions) and Trustee Savings Banks (£30 millions) ...	240
Treasury Note Reserve	240
Ways and Means Advances (Public Departments, £160 millions, less amount included under Treasury Note Reserve), say	70
Insurance Companies, approximately	350
Railway Companies	80
Add to preceding items to bring to par value ...	277
Balance of Treasury Bills not included above, and held by various concerns, bill brokers, and others needing liquid resources, largely as part of the floating money system of the country ...	300
Held by private persons liable to Estate Duty ...	2,350
Held by foreigners, trusts, charities, trade unions, joint stock companies, etc.	1,650
	6,592

264. On a survey of these figures, does the destination of the debt interest appear to be propitious to national saving? We suggest that it does. A large part of the debt is held by the banks and in connection with the monetary system of the country; here the interest will in general be placed at industry's disposal. Another large part is held by joint stock companies, and the interest is a direct payment to industry; the same is true of interest paid to those individuals who will invest it in private businesses of their own. Again, the greater part of the £2,350 millions ascribed to private persons liable to Estate Duty must belong to individuals who are comparatively well-to-do, and have therefore a relatively good capacity to save.

265. But savings have to be considered in quality as well as in quantity. Debt holders are sometimes regarded as a class of particularly cautious people; it is supposed that they are less likely than others to use their savings in such a manner as to stimulate the healthy taking of risks—they will invest in gilt-edged securities rather than in the ordinary shares of public companies. It seems to us that there is some slight foundation for this idea, although it has often been exaggerated. War Loan holdings are obviously attractive to people who are cautious by temperament, or, as in the case of trustees, by necessity; and such persons, when they have savings out of War Loan

interest to invest, are likely to prefer something fairly secure, and, when they do invest in industry, to choose the debentures of a big well-known company rather than the shares of one that is enterprising but less known. On the other hand, the fact that a man holds a good block of War Loan and can rely on a nucleus of safe income may sometimes incline him to seek a higher but less certain return on his other savings.

266. We may now pass to the effect of the transfer on the distribution of wealth. It is widely held that the payment of interest on the internal debt is harmful, as involving a transfer from the poorer to the wealthier.

Viewed in isolation, it certainly does involve a transfer of this kind. The taxpayer, whatever his means, contributes his quota towards each of the items in the expenditure side of the Budget. As the debt is mainly held by the Income Tax paying class, and as the indirect taxes of those who are not liable to Income Tax contribute to the debt interest, it follows that in this respect there is a transfer from the poorer to the richer.* In a similar way, in so far as the debt holdings of Income Tax payers increase according to their wealth on a more progressive scale than that of their total liability to taxes, the payment of debt interest involves a transfer from poorer to richer within the Income Tax paying class.

267. Whether the transfer of wealth from those who are not liable to Income Tax to those who are is on final balance harmful is another question. It cannot properly be judged without taking into account all the other items of Government expenditure, including the social services, in which there is a transfer from the richer to the poorer—a transfer which might have been greater, if there had not been so heavy a debt charge. Much also depends on the character of the taxes and the question is one on which, at this stage in our Report, we must reserve judgment.

268. We must, however, analyse the significance of the transfer a little further, both as it affects the distribution of wealth and as it affects savings (*cf. paras.* 263-265). Two points require attention. The first is suggested by the fact that the debt-holder can at any time sell out and invest his money elsewhere; the second turns on the fact that the Income Tax paying class, to the extent that they are paying their own War Loan interest, are as a class getting no money return on their investment.

---

* The service of the debt (internal and external) is sometimes regarded as a first charge on the Income Tax revenue, or on the total revenue from the Income Tax paying class. From this point of view it is said that, while Income Tax payers are paying for the War, and the debt service does not involve any transfer to them from those not liable to Income Tax, the latter class are providing far the greater part of the current services. But allocation of this kind can hardly be justified. The true way of stating the point is to say that the total amount contributed to all services by the Income Tax paying class does not very greatly exceed the amount required for service of the debt.

269. So far as money for the War was raised by borrowing, individuals who would otherwise have had to pay extra taxes were allowed to keep their savings : they did not have to put the whole of them into War Loan, or to lock them up there permanently. It may therefore be said that they now owe to the War Loan system an income which, in individual cases, takes the form not of debt interest, but of industrial dividends, etc. In other words the effect of the system is to be found in the position of persons who may hold no War Loan, or indeed may never have held any, and not only in the position of the present holders : it is not wholly reflected in the payment of debt interest to the latter.

270. In some aspects this point is not important. The mass of the debt, in spite of transfers between individuals, must no doubt continue to be held by the wealthier members of the community. But it cannot be assumed that the wealth or character of the present holders is, *en bloc*, the same as that of those who have benefited by the War Loan system, or even as that of the original holders : the debt may, for example, have settled more largely into the hands of trustees and other cautious investors. The transfer involved in payment of interest is therefore only a partial index of the way in which the War Loan system has affected national savings and the distribution of wealth.

271. We may now pass to the further point we have mentioned. The second stage of loan finance was to increase taxation in order to provide interest. No special tax was allocated to this purpose, and each head of taxation is properly to be taken as contributing proportionally to it. Income Tax payers who held War Loan had to pay heavily towards their own interest : those who held no War Loan had to pay heavily towards the interest of others. As a class, the Income Tax payers provide much the greater part of their own debt interest. To the extent that they do so, they are getting no money return on their investment. The wealthy who pay tax at a very high rate are particularly hit : the deficiency of any money return depresses their income and their saving power in an important degree. In this particular aspect it certainly appears that the disparity of wealth has not been increased by loan finance.

272. The point, however, must not be pressed too far. Everything depends on the alternative with which the present situation is compared. It is not much use to speculate how the distribution of wealth might have been affected, had there been no War and had savings continued to flow into productive industry. It is much more pertinent to enquire what would have happened, if the money for the War had been raised wholly, or more largely, by taxation. Part of the extra taxation might have been levied on high wages, but it is legitimate to assume that the rich would have suffered more severely than they have under the loan system : for loan finance, by spreading

49038 Cx / 5 108865 D

taxation over a long period, has enabled the burden of the War to be distributed over a larger section of the community than would otherwise have been possible. The immediate effect of heavier War taxation would have been to diminish the inequality of wealth, whatever the subsequent reactions might have been. This appears to be the fundamental argument lying behind the contention that the payment of debt interest involves a hurtful transfer of wealth from poor to rich.

273. It is sometimes further contended that payment of debt interest involves on the whole a transfer from the more active to the less active. The contention appears to be slightly questionable. If Mr. Layton's analysis be accepted as broadly indicating the true distribution of debt holdings, the average activity of the debt-holder would hardly appear to be less than normal. Evidently a great many of the holders, individual and corporate, are extremely active. It might be suggested, however, that the growth of the debt has had some influence in increasing the number of rentiers and the amount they draw from the community. We doubt whether this is so. There were, of course, special opportunities for making large profits during the War, and this has no doubt led to the creation of a new class of rentiers. On the other hand the change in the value of money hit the old class of rentiers very hard. Again, the heavy taxation has certainly not conduced to an increase in their number.

(iii) *Repayment of Internal Debt.*

274. Many of the considerations with regard to the payment of interest on the internal debt have an application also to repayment of that debt; there are, however, some differences. We are here discussing only the existing arrangements for debt repayment.

275. The argument that taxation for the service of the debt increases total savings is very strong as respects taxation for repayment of debt. It is indeed incontestable, so far as it goes. It can safely be taken that very little of the repaid loan is treated as income and spent on consumption; the proportion of taxation which is paid at the expense of consumption must be much larger.

276. Many witnesses thought it likely that debt-holders would seek to re-invest in gilt-edged stocks. This view was put strongly by Mr. Keynes, who suggested that " conservatism, obedience to convention and lack of knowledge . . . exist in the greatest degree in the gilt-edged type of investor " (Q. 3978). It was discounted by Professor Cannan, who considered that it is a mistake to " think of the holders of debt as entirely different people, a particular class of unenterprising persons, and so on . . . If I am going to get paid off, I am not to be regarded as having a predilection for Government stock simply because during the War I got stuffed up with it. It is much more likely,

I think, that I am going to launch out a little. Generally speaking, the debt is not held by a particular class of bondholders such as Cobbett used to think of. Whenever Cobbett saw a new house after the Napoleonic War, he always said it had been built by the bondholder " (Q. 818).

277. Our own conclusion, broadly, is that the debt-holder is likely to retain some fairly definite preference for the gilt-edged. But the ultimate effect on industry is not determined by the action of the debt-holder alone. For, as Mr. McKenna has pointed out, even if he takes the expected course, the seller of the gilt-edged security has in turn to reinvest somewhere, " in a new industrial or a new foreign or municipal loan." The money " might go through fifty hands before it finds its ultimate home in some new security," but it would not take long to reach industry (Q. 1943-1950).

278. Professor Cannan referred to the suggestion that savings are diverted into foreign stocks as " more alarming " than any internal diversion (Q. 818). At the present rate of debt repayment we do not think the risk of its encouraging foreign investment can be serious; we refer later to the question of more rapid repayment, and notice the interesting views in that connection elaborated before us by Mr. Keynes (*cf. para.* 980).

279. If payment of interest on the debt involves an annual transfer of income from the poorer to the wealthier, repayment of capital out of the proceeds of the same taxes must also represent a lump sum transfer of similar character. Again, if payment of interest can be said to involve a transfer from the more to the less active, the same must be admitted of repayment; we have, however, expressed our doubts on this latter point.

(iv) *Pensions.*

280. War Pensions at present account for about £64 millions of expenditure, but they are of course an annually decreasing charge. As Mr. Layton expresses it " this item of expenditure is definitely an added war burden, but it is one which no one would wish the nation to evade " (*E. in C.*: 9 (iii)).

Purely from the standpoint of production the burden per million pounds is heavy, since a considerable part of the £64 millions goes to pensioners who cannot work, and since not much out of it can be saved. Amount for amount, the burden is heavier than that of the internal debt service; on the other hand it is lighter than that of the external debt service, since it constitutes a definite support of purchasing power within the country.

281. Similar considerations apply to the non-contributory Old Age Pensions, and to the Government contributions towards the Widows', Orphans' and Old Age Contributory Pensions for which provision has now been made. The application of the revenue to these ends goes to support the standard of living of the people

at times when it is commonly threatened. The primary justification of the expenditure is to be found from the distributive point of view. Indirectly, however, production should in the long run benefit, not merely on account of the support of purchasing power which the pensions afford, but on account of the worker's greater sense of security.

At present the Old Age Pensions cost about £28,000,000 a year. Past expansions in the population, combined with its generally increasing age, are continuing to swell the number of claimants and the probability is that these causes, apart from recent alterations in the system, would have doubled the cost in forty to fifty years' time.

The cost to the Exchequer of the new pensions to widows and orphans is equalised, for the first ten years of the scheme, at £4 millions a year, the additional cost of Old Age Pensions under the scheme rising in that period from £1,700,000 to £4,700,000. The total cost to the Exchequer for both new and old pensions is estimated at £51 millions in 1935-36 and £70 millions in 1960-61. Although the scheme will eventually be on a self-supporting basis, there will be a perpetual charge on the Exchequer of some £90 millions a year, representing the interest on the cost of bringing the scheme into operation before the accumulation of a capital fund.

(v) *Defence.*

282. Little need be said here. The determination of the amount of essential expenditure on defence, at a time when economy is so desirable, cannot fail to present a peculiarly difficult problem to those responsible. It may generally be said of expenditure on defence that, in a rigidly economic sense, it is unproductive.

(vi) *Social Expenditure.*

283. Of the State expenditure discussed under the five preceding heads, the immediate advantage of the first three taken together (debt expenditure) may be said to accrue on balance to the wealthier section of the community. The immediate advantage of the fourth (pensions) accrues on balance to the poorer section, while that of the fifth (defence) is so general that no distinction can be made in either direction. The immediate advantage under the present section is deliberately conferred upon the poorer.

284. The most emphatic alteration in distribution is under the present head of social expenditure. If it were proved that the taxation required for this expenditure was damaging to production, it might still be possible to justify it on the grounds of general advantage. For many social objects wise collective expenditure is clearly more economic than expenditure left to the individual.

If, as a further step, it were proved that in some ways the expenditure was not making good its claim to benefit society, the fault might not lie in the general directions of the outlay: it might be due to mistakes in the type of education, deficiencies in the science of social health, or flaws in the scheme for relieving unemployment. Expenditure on the present scale is experimental, and is perhaps liable to errors and abuses which time may correct. It may be pertinent to quote one of our witnesses, Mr. R. H. Brand, who, while not objecting to Government expenditure on social objects (Q. 1513-15), expressed himself as "out of sympathy with a great deal of modern thought which regards very large expenditure by the Government on social schemes of all kinds as synonymous with progress," and which does not properly weigh "the probable or possible social advantages" against "the certain disadvantages of less saving and less enterprise, leading in their turn to a lower standard of life all round and less employment" (*E. in C.*: 5). We are disposed to agree that modern thought is inclined to regard social expenditure as good in itself or bad in itself, without due discrimination. But it is difficult to weigh social advantages except by the empirical test.

285. Social expenditure brings the claims of production and distribution into sharp contrast, and to a certain extent into conflict. The greatest social advantage and the best interest of production are, however, not so hostile to each other as might appear. For, as Professor Pigou has said, "from a distributional point of view, it would plainly be best to take nearly all your money from the rich people, but that might be so bad from a productive point of view that the poor people would in the end be damaged" (Q. 574).

The difficulty is to know where the balance should be struck. As Mr. Layton notes, "Social expenditure tends to produce its full result after an interval, and clearly a sudden increase might for the time being have the effect of reducing the national income" (*E. in C.*: 9 (v)). It is clear enough that the distribution of wealth in this country is very uneven, and that social expenditure is not only highly necessary as a matter of humanity and social justice, but is also, up to a point, essential to the promotion of industrial efficiency. It makes for physical and mental well-being, for happiness and for energy. Moreover, it supports and steadies the purchasing power over consumption goods, which is unreservedly beneficial to industry, provided there is a demand for productive goods in due proportion

On the other side must be set the hard fact that there is a limit to what the country can afford. This aspect will come into prominence as we discuss the effect of the several existing taxes.

(vii) *Other Services.*

286. This expenditure represents in the main the cost of administration of all Government activities, including the administration of justice and the collection of taxation. Generally, therefore, it is a payment for services rendered, or for goods delivered. Taken as a whole, the advantage of this expenditure cannot be said to accrue to any particular section of the community, since the services concerned are widespread and affect everyone in some direction.

Expenditure in General.

287. As we have said (*para.* 256), it is not within our reference to hold a specific enquiry into Government expenditure outside the service of the debt. In the preceding remarks we have noted the necessity or the value of expenditure in certain directions. Absence of further or specific reference must not be taken as implying acquiescence in the economic justifiability or necessity of particular expenditure. But we at least express the strong view that, since the revenue to be raised has reached such a formidable total, and the various taxes necessary thereto are at a point of hardship or economic reaction, expenditure should be most closely scrutinised in order to be sure that on balance it presents a more than usually ample margin of economic advantage.

SUB-SECTION II.—THE USE OF THE TERM "INCIDENCE" AS DISTINCT FROM "EFFECTS."

288. We may now pass to a discussion of the incidence and effects of the several existing taxes. By way of preface, we may explain the meaning which we think it convenient to attach to the term "incidence of taxation." In general usage the term covers not only the initial burden of a tax, but also the whole range of consequential effects. Economists, however, have given it a narrower meaning. For them "incidence" is only concerned with the question on whom the more immediate burden of the tax as a tax rests. This is the first thing to be decided about any tax. It is to be distinguished from the question of further effects, which may be exceedingly important. For instance, the burden of a tax may rest upon an employer, and in consequence he may cut down his staff; in such a case the effects of the tax may be more serious to the employees than to anyone else, but the incidence of the tax is not said to be upon them.

For the purpose of analysis we think it useful to follow the economists in using the term incidence of taxation in this narrow sense, distinguishing it sharply from the further effects of taxation, and dealing separately with the latter.

289. If the payer of a tax is unable to get rid of it by passing it on to anyone else, we understand the incidence of the tax to be upon him. A tax may, however, be of such a kind that the payer can pass it on, or "shift" it, through adding it to the price of an article which he is selling. So far as he succeeds in putting the tax into the price, he escapes the tax, and the purchaser bears it, unless he in turn can shift it in some further exchange transaction. In this case we speak of the incidence as being not on the actual payer but on the purchaser.

290. This is a simple conception, made widely familiar by the general idea of direct and indirect taxation. Complications only arise because the whole process of taxation acts as a stimulus applied at all sorts of points and setting up all kinds of reactions. To include any of these reactions within the meaning of the word incidence can, in our opinion, only make for confusion. Such confusion has often indeed arisen in the literature of the subject, owing to lack of uniformity in the use of terms. We may illustrate briefly some of the possible reactions we have in mind :—

(*a*) It may happen that an employee who bears a tax succeeds, on that account, in obtaining an increase of wages against the tax-burden.

(*b*) A trader who shifts a tax by adding it to the sale-price of his goods may suffer from reduced sales. On balance, it may prove that he has lost and not gained by shifting the tax.

(*c*) A trader who bears a tax may, by reason of its pressure upon him, be led to work harder or to examine more closely the possibility of reducing his costs. This may lead to good results counter-balancing the effect of the tax.

291. It will be observed that the first and third of the above cases, however different in other respects, are alike in this, that the incidence of the tax is upon the individual considered, although the immediate burden of the tax is the cause or occasion of his obtaining a benefit which can be set on the other side against it. In the second case the individual escapes the incidence of the tax, but in so doing he incurs a loss which may outweigh his gain.

The important point is that in all these cases the benefit or loss which has to be set over against the bearing or the shifting of the tax may properly be distinguished as a consequential balancing factor, not affecting the incidence of the tax and not to be confused with it. Such off-sets may, in practical questions, be of greater consequence than immediate incidence.

292. Thus it follows that the enquirer who has established the incidence of a tax has only taken a preliminary step towards appraising its effects. He has done the first thing that is necessary : as yet, however, he cannot even say with certainty that the person who bears the tax will not gain some compensating

advantage as a result of it, or that the person who shifts it will ultimately gain from so doing. Still less has he reached a point enabling him to decide the broader reactions on the whole community, e.g., the effect which the tax may have in deterring people from enterprise.

SUB-SECTION III.—THE INCIDENCE OF THE INCOME TAX.

(1) *Opposed Theories: the Economic Argument.*

293. The question of incidence is of special practical moment in the case of the Income Tax. There are two current views; according to one a general Income Tax cannot be shifted by the person on whom it is laid, while according to the other it can be shifted, and is in fact shifted, in the form of an addition to price.

If and so far as the latter view is correct, the Income Tax must abandon part of its chief claim to virtue as a method of taxation. However carefully graduated, it can no longer be said to satisfy the canon of ability to pay, if the burden is indiscriminately shifted: if this happens, no one can tell how much tax he really suffers. This implication is usually not developed by those who advocate the view that Income Tax is added to price. They more often pursue the argument that Income Tax is responsible for raising prices, and is therefore a potent factor in depressing trade.

294. Several of the business men who came before us were of the opinion that Income Tax enters into prices. Mr. E. B. Tredwen, representing the London Chamber of Commerce (Merchants' Section), suggested that, in fixing his prices, a trader puts on to his costs "a margin of profit for himself, and of course it is his profit that is subject to the direct Income Tax, and if he wants to get a sufficient reward for his own exertions, he must put on an addition to his price sufficient to cover the profit to the Government as well as the profit to himself" (Q. 7297). Mr. P. D. Leake contended that "apart from current price fluctuations due to changes in supply and demand, the general level of selling prices must inevitably be based upon the cost borne by employers incidental to production, and this cost includes the employers' disproportionate burden of progressive taxation. Therefore the effect of this extra tax burden must be to foster the maintenance of high prices, and so to lay upon the wage-earners an extra burden of altogether unknown extent, but which may probably amount to not less than 85 per cent. of that part of the employers' Income Tax burden which is inevitably reflected in the retail prices of the commodities purchased by the wage-earners." (*Ev.*, p. 333; *E. in C.*: 24). Mr. R. S. Wright, representing the National Union of Manufacturers, took an even more extreme position. He held the opinion

that " the difference between direct and indirect taxation hardly exists in actual fact." He was " convinced that the burden becomes automatically distributed by a law of political economy that defies all Acts of Parliament." (*E. in C.*: 12.) A more general view was that Income Tax tends to be passed directly into price, but that the tendency is subject to certain conditions. The Association of British Chambers of Commerce pronounced as follows. " Although theoretically Income Tax is levied on profits, when a trader endeavours to ascertain his costs with a view of fixing prices, he often takes into account, at least indirectly, the amount of Income Tax he will have to pay, and, if the market conditions permit, fixes his prices at such a level as would yield to him the minimum net income he desires to obtain or actually needs." (*Ev.*, p. 290; *E. in C.*: 51.) Sir James Martin, the Association's witness, added, " You do not pass the specific tax on." (Q. 4217.) Mr. Glenday, who appeared on behalf of the Federation of British Industries, thought there was an unconscious tendency, which could not be measured, to put tax on to price at one or other stage of production. " Trade," he said, " is a speculative thing, and if Income Tax is high, and you are not quite sure exactly how your sales are going—it is in a sense a risk which has to be insured against." (Q. 4772-4782.) Some witnesses took the view that there is a clear tendency for Income Tax on wages and salaries to be added to prices, since—it is argued—employers have to pay higher remuneration on account of the tax, and the tax therefore enters into costs of production.

295. A number of witnesses considered that, without directly entering into prices, Income Tax affects them by curtailing production and reducing supply. This view, however, is pertinent to the consequential effects of the tax, and not to its incidence.

296. The view that the Income Tax cannot be shifted, at any rate normally, was taken by a considerable number of witnesses. " In my opinion," Sir Fredric Wise stated, " as a general rule Income Tax does not enter into the contract prices. When times are bad the most important point is to get the volume of work." (*E. in C.*: *Ans.* to Q. 10.) There was a general consensus of opinion among economist witnesses. Income Tax, Professor Pigou pointed out, " is assessed on the profits resulting from trade and industry, and if, as may be presumed, people are already charging the prices that yield them the best profit, the removal by the State of a portion of the profit will not tempt them to fix prices differently." (*Ev.* p. 41; *E. in C.*: 30.) The argument was very fully developed on its economic and statistical sides by Mr. W. H. Coates, whose important memorandum on the subject we print as Appendix XI. We also reprint, by permission, Professor Seligman's closely-reasoned paper on " Income Taxes and the Price Level." (*Appendix* XII.)

297. As against the view that Income Tax on wages and salaries enters into the trader's costs of production, and is passed

on by him in higher prices, it may first be noted that the great mass of wage-earners, after account has been taken of personal reliefs, allowable expenses, etc., are not liable to pay Income Tax at all; where liability exists the amount of it depends on personal circumstances, varying from one individual to another, of which the employer could not take cognisance. It is true that, in the restricted area of higher wages and of salaries, it is in some cases the practice of the employer to regard not only the increase in the cost of living, but also the weight of the Income Tax; the outstanding instance is that of banks which have undertaken to pay the tax on their employees' salaries. But the area of industry, apart from banking, over which this practice is adopted —either in the form of higher salaries or of salaries " free of tax "—appears to be relatively very small.

298. We arrive, then, at the position that Income Tax on remuneration may occasionally enter into costs of production to a limited extent, in the case of the higher-paid employees of particular concerns. This, however, is very far from saying that, even within these limits, the tax is reflected in higher prices. The only clear case where a trader might be able to put up his charges with impunity would be the case where all his competitors had similarly agreed to pay salaries covering Income Tax. In fact, it does not appear that such a uniform condition is approached in any branch of industry outside banking, and even as regards banking it would be difficult to show that banks have charged more for their services than they would otherwise have done on account of the Income Tax which they have paid on the salaries of their staffs.

Where the individual trader who pays higher salaries on account of the Income Tax is in competition with other traders who do not follow the same practice, he is in no better position to increase his prices on account of the tax on his employees' salaries than on account of the tax on his profits.

299. We may pass then to the main question, viz., whether the trader can shift the burden of the Income Tax on his profits by putting it directly on to his prices. The view that he can do so (as distinct from the view that the tax indirectly raises prices by damping down enterprise, etc.*) implies that the trader is free to fix his own terms largely irrespective of demand or of competition. It is necessary to examine how far his freedom is in fact circumscribed. We propose to set out briefly the economic argument.

300. The distinctive case of the monopolist may first be considered. In what follows (*to the end of para.* 302) we merely repeat in our own words the general economic doctrine of the determination of monopoly profit. It is, of course, recognised that in actual fact monopolies vary indefinitely in kind and degree,

* This view is discussed under "The Effects of the Income Tax"—see especially para. 438.

and are hardly ever absolute. Even the monopolist is powerless against the laws which govern the price that people are willing to pay. As he raises or lowers his supply prices, so will demand, unless it is highly inelastic, contract or expand, and so will he dispose of less or more goods. He is free from competition, so far as his own particular commodity is concerned, but he has to reckon with the rival claims of totally different commodities. If he puts his price too high, the consumer may exercise his purchasing power in quite other directions.

301. The profit of the monopolist, like that of any other trader, will depend on two factors—the price, relatively to the cost of production, at which he can sell each article or unit of supply, and the number of units he can sell: it is generally true that, the higher his price, the smaller will be the number of units. His problem is to find the price which, combined with the units he can sell at that price, will yield him the greatest profit or "maximum monopoly revenue."

302. He cannot do this easily, for the elements he has to deal with are not fixed and cannot be precisely calculated in advance. He cannot foresee exactly how his machinery will stand the strain, or how effectively his employees will work. Nor can he accurately measure future variations in demand, even if he is selling a staple commodity. Two things, however, he can generally rely upon. As output is increased, there comes a point at which the effort and expense required for each further unit begins to go up. At the same time—subject always to caprice and elasticity of demand—the price which can be obtained tends to fall. If supply is increased far enough, a margin is reached where the last-added unit yields neither profit nor loss, cost being just covered by price. The point of maximum monopoly revenue will normally lie well within this margin, so that the whole of the produce can be marketed at a profit. The aim of the monopolist will be to reach that point, without going beyond it. In actual conditions he is unlikely to achieve entire success, since, in addition to the difficulties of forecast which we have mentioned, he may have to take into account the risk of his monopoly being broken. This possibility may induce him to put out a greater supply than he would if he felt absolutely secure. So much is the common factor of economic teaching on this subject.

303. How will his action be influenced, if a tax is imposed on income, or if the rate of an existing Income Tax is increased? The tax is laid not upon his sales, like a turnover tax,* but upon his margin of profit. Consequently it will not affect his costs of production: again, it will not affect the price which the public are willing to pay for his goods unless, indeed, it makes them

* For an illustration of the different effects of an Income Tax and a tax on units of turnover see footnote to Section I of Professor Seligman's paper—Appendix XII.

more careful purchasers (*cf. para.* 312). That is to say, it will not disturb either of the elements on which profit depends. His action therefore will not be influenced, unless the tax is so heavy that he no longer thinks it worth while to make the required effort in order to obtain the largest possible income. In such an exceptional case he may possibly put something on to his price on account of the tax, and although it reduces his profit, he may prefer this to a rather greater profit at the expense of a greater effort.

304. We may sum up the position of the monopolist by saying that he cannot with impunity shift an Income Tax : normally the price he charges will not in any way be directly affected by the imposition or increase of such a tax. The exceptional case will be rare.*

305. The competitive trader will find it still more difficult to pass on to the consumer any part of his Income Tax burden. He will not be in the same position as the monopolist to fix the price that will pay best, or (since price and quantity are mutually dependent) the most profitable quantity of supply. He is limited by the existence of competition in several important ways, of which three may be mentioned. First, his goods are subject to comparison in point of quality with the slightly differing goods of other producers. It may be difficult for the producer to judge how the demand for, e.g., clocks and watches will compare with that for, e.g., gramophones. But it will probably be still more difficult to anticipate how slight differences in the make-up of a clock will appeal to the public taste. If the trader in clocks and watches were a secure monopolist, he would himself reap the trade advantage of any improvement : in competition, however, he has to take his single individual chance and face the uncertainty of demand for his particular make. A second limitation on the competitive trader is that, apart from quality, he cannot control the supply of his rivals, and any extra quantity on the market is a force which automatically tends to lower prices, whether the producer likes it or not. Thirdly, he cannot prevent his competitors from attempting to reduce their costs and undercut him. He cannot safely put up his prices either directly, or by limiting supply.

306. In free competition in a progressive community—subject, of course, to disturbing conditions—prices are always tending to fall and aggregate sales to expand. The individual trader natur-

* Of course a "benevolent monopolist," who has consciously refrained from charging as high a price as in his own interest he could have done, may be induced by an increased Income Tax to put his price up. A clear parallel is to be found in the professions, where e.g. the eminent doctor or lawyer has not attempted to fix his fees so as to yield the highest possible income : he may raise them somewhat on account of a heavy addition to his tax liability. These, however, are not true cases of Income Tax being passed on. They are analogous to the case where the trader has *unconsciously* been charging too little (*cf. para.* 312 ; *also* Q. 8905 *et seq.* in the evidence of Mr. Coates).

ally desires that, if this happens, he may secure the advantages of it as far as possible for himself. Thus the competitive business is vitally concerned to produce as cheaply as it can and to extend its sales. Unlike the monopoly it tends to go on producing right up to the point where, owing to the fall in demand price, the last unit costs as much as it can be sold for: it is frequently carried further. "The producer," as Mr. Coates pointed out, "is always endeavouring to keep the final unit within the profit sphere, but in his search for additional business and additional profit he is constantly approaching the marginal line at which no profit will result, and often he will find himself carried over the line into the region of loss on his marginal units. . . . . In these conditions [the actual conditions of life] the temporary positions of demand and supply are the governing factors, and price is determined by the cost of the marginal products, the sale of which yields no profit, and may indeed yield a loss." (*Appendix* XI, *Part* II, *para.* 8.)

307. Owing to the great diversity of ability and circumstance, the cost of production—not, of course, the marginal cost, but the average cost spread over the total—will fluctuate considerably as between different concerns producing the same article. The surplus of price over cost will be wider in some cases and narrower in others. In the case of the marginal producer, the business that is struggling hard to keep alive, there will be little or no surplus, or there may be a loss. In this connection figures of great value, tabulated from the records of the Inland Revenue Department, were provided and commented on by Mr. Coates (see *Appendix* XI, *Part* IV). They relate, quarter by quarter, to the two Income Tax years 1920-21 and 1922-23, and compare the percentages of profit to turnover for a large number of companies in each of seven trade groups, viz.

Cotton,
Wool,
Iron and Steel,
Metals,
Food,
Wholesale Distribution,
Retail Distribution.

In relation to the present argument, the point of importance, as Mr. Coates observes, is that in each trade group "a material portion of the total turnover is being done at a loss or at no profit. In periods of boom, when demand is far in excess of supply, competitive conditions tend to disappear, and to be replaced by monopoly considerations. But even in the most profitable period here analysed, that to June, 1920, there is evidence that in practically all groups some part of the total turnover was sold at a loss. . . . The existence of marginal concerns is clearly indicated." (*Appendix* XI, *Part* IV, *para.* 27.)

308. These statistical results represent a basis of solid fact, and afford strong confirmation of the view derived from processes of reasoning that price is determined by considerations into which the Income Tax does not directly enter. There is no sign of traders demanding a price to cover Income Tax as a condition of their carrying on business. On the contrary, it is indicated that the relation of profit to turnover varies remarkably, and that a percentage of producers will regularly be found carrying on just above or below the margin where profit turns into loss. In a free competitive market with ample supplies in relation to demand, price at any time is measured by the cost of production to the marginal producer. That price yields no profit and is not liable to Income Tax : no element of tax can enter into it.*

309. Mr. Coates adduces a further argument from the comparison of pre-war and post-war profits, the years 1912-13 and 1922-23 being taken. This comparison is worked out in Part VI of his memorandum (*see Appendix* XI). He shows that the figures yield no evidence of any increased rate of profit on turnover, such as would be necessary to yield the same net reward per unit when account is taken of the 328 per cent. increase in the rate of Income Tax.

The two years taken were, of course, very different as regards the condition of trade, but the figures are very striking.

(2) *Hypothetical cases: retail and other trade.*

310. We think that the economic argument, as presented by Mr. Coates and by Professor Seligman in Appendices XI and XII, is conclusive in establishing the general rule that Income Tax is not passed on in higher prices. In order to see, however, whether exceptions may occur, it will perhaps be convenient to approach the question in a different way, and enquire what effect the Income Tax will have in particular hypothetical cases. It may be observed here that the public limited company has not the same motive for action as the private individual trader. So far as a company distributes its profits, it recoups itself by deduction of tax from its shareholders, in the fluctuation of whose individual liability it is not interested; to this extent the rate of tax is a matter of indifference to it. Consequently, as compared with the private trader, the company has little inducement to seek to raise its prices on account of an increase in the rate of tax. This point is of much practical importance, for in the case of many commodities the bulk of the supply is by limited companies.

* This conclusion is in no way inconsistent with the view that Income Tax, by depleting the reserves of marginal firms in previous years when they made profits, may hasten them into bankruptcy, and may also deter people from entering into business. In these ways it may be held that the Income Tax reduces supply and so leads to higher prices—clearly an indirect effect which it is very necessary to examine, but which does not concern the question of incidence here under discussion.

We will direct our attention, then, to the individual trader, who is directly concerned in the rate of Income Tax, remembering, however, that among the factors more or less limiting his freedom of action is the competition of the public company.

311. Let it be assumed that, prior to the raising of an Income Tax from, say, 2s. to 5s. in the pound, there are three individual traders answering to the following description :—

(*a*) *Trader* 1 has been charging too high a price : i.e., it would have paid him better to reduce his price per unit and increase his sales;

(*b*) *Trader* 2 has been charging the price which, taken in conjunction with the sales possible at that price, yields the highest profit;

(*c*) *Trader* 3 has been charging a price below the normal competitive level : i.e., it would have paid him better to increase his price per unit at the cost of a slight diminution in his sales.

Let it also be assumed that, apart from the raising of the Income Tax, the conditions affecting supply and demand remain the same.

312. *Trader* 1, who has been charging too high a price, may conceivably attempt to put his price still further up on account of increased Income Tax. On the other hand, the tax may lead him to explore with greater care the question what price will pay him best, and in the result he may lower his price. Another factor which may influence him in this direction, if he is a competitive trader, is that the consumer, who is also suffering from the increased tax on his income, will tend to be more careful to buy in the cheapest market.

Trader 2, who has been charging the most profitable price, may attempt to pass on the burden of the additional tax. But *ex hypothesi* he will himself suffer,* if he carries through his attempt.

There remains *Trader* 3, who has been charging too low a price. Let it be supposed that he puts up his prices on account of Income Tax, and improves his position as a result. No one disputes that this will sometimes happen. The motive is the

* Possibly there are very slight reservations to be made. It might pay a monopolist to put up his prices, if the increased Income Tax were to make his customers willing to pay more for their goods. The well-to-do taxpayer who is hit by the tax, and has less net income to spend, is not likely to be affected in this way in his general expenditure ; he will tend rather, as we have noted, to be more careful with his money. But it is perhaps just conceivable that those who are exempt, and those who only pay a small amount of Income Tax, may have a vague feeling that, when business is heavily taxed, they must expect to pay high prices ; as the elasticity of incomes is limited, this feeling cannot be effective in relation to purchasers generally, but it may be so in relation to specific classes of goods.

It might also be suggested that, on a long view, the monopolist may gain by putting up his prices, even if he suffers immediately. But this can only happen in a rare and remote combination of circumstances.

Income Tax, and the trader, actuated by this motive, not only attempts to raise his prices, but succeeds in doing so.

It is important to recognise here a direct effect of Income Tax on prices, but if *Trader* 3 is now charging the price that will pay him best, it is incorrect to say that the Income Tax has been shifted, or that the tax itself has entered into prices, for the price could have been raised with precisely the same result even if no Income Tax had been imposed.

313. Professor Seligman remarks that in a period of rapidly rising prices (a sellers' market), the inducement to the marginal producer to cut prices is removed, and under those circumstances the imposition of a tax of any kind will afford the producer an excuse for asking a still higher price. He points out that such conditions are temporary and emphasises the point that the tax is really an excuse for, rather than a cause of, high prices. This view was endorsed by the Royal Commission on Food Prices.

The case is merely a variation of that just considered, except that here it cannot even be pretended that the tax is a motive in putting up the price.

314. For the purpose of the simple examples we have taken it was assumed that, apart from the increase of the Income Tax, conditions affecting supply and demand remained unaltered. In reality they are continually shifting. This does not alter the fact that the most profitable price is unaffected by an increase of the Income Tax. It does suggest, however, that the task of pursuing the most profitable price in conditions that are constantly liable to change is no easy one. This suggestion is reinforced by the fact that the system of cost accounting as usually practised is still in an early stage of development.

315. There is no doubt that in some trades (especially, e.g., in retail luxury trades) it is extremely difficult to judge the best price; it may, indeed, be impossible to judge with any certainty: moreover, where taste and fashion are concerned, conditions are so constantly changing that, even after the event, it will be impossible to say how near the prices charged have been to the best prices. It will be a case of often-repeated experiment, with only general guidance from past experience, and policy will be determined as much by flair, business instinct or bargaining capacity as by any regular calculation. It is easy to see that in such speculative conditions a trader may be led (as far as competition will allow him) to charge more than he otherwise would by a heavily increased Income Tax. A definite price per article is, at any rate, something firm and fixed. Everything else is uncertain. He may be led to charge a price above the most profitable level. The Income Tax, although it does not enable him to get a higher price than he otherwise could, induces him to put his price up: here, then, Income Tax may be said to enter into prices, so far as it

causes the trader to add something over and above the ideal economic price.

Similarly, Income Tax may have some effect in deterring the efficient trader, who has cut down his costs, from making a reduction in price.

316. It may be said that competition, where it exists, will force the trader who has put his prices too high to bring them down again. But two practical considerations must not be overlooked :—

(1) The extremes of absolute monopoly and of ideally free competition are very exceptional. In reality, trade shows every degree between the two.

(2) Competitors are commonly engaged in selling not the same, but only similar, articles.

The second of these considerations is not really distinct from the first. For advertisements which succeed in persuading the public to refuse imitations do create at a considerable extra cost, which is not always recouped, some element of monopoly : the public accept the particular article as being very different (instead of only slightly different, as it may in reality be) from a dozen other makes. Another factor which modifies the effectiveness of full competition is locality. This remains of some importance in spite of up-to-date transport and the long range competition of advertising.

317. It seems reasonable to infer that, where competition is relatively ineffective, a trader who has put up his prices on account of the Income Tax may for a while be able to maintain them.

The argument, however, cannot be left here, for the retail luxury trader, whom we have instanced, is the extreme case rather than the type.

318. The large number of small retailers of every kind, in town and country, derive some advantage from locality and personal influence. Many people find it convenient to make their day to day purchases locally, some because it saves trouble, others because it enables them to inspect the goods and do a little bargaining. On the other hand, there are strong reasons for thinking that the small or moderate retailer will not be able to pass on the Income Tax. In the first place, so far as he enjoys a favourable position, he will probably have exploited it already. In the second place, he is threatened in most places by the large retailer, the multiple shop. In the third place, the great majority of retailers are either not liable to Income Tax or are liable to a quite insignificant amount. They pay little or nothing, and the question of shifting Income Tax hardly arises. Moreover, they endanger with their competition any more prosperous rival who attempts to add his tax on.

319. With the large retailer it is usually a primary concern to increase the area of his sales. He has, therefore, to take serious account of the small man who has little or no Income Tax to pass on, as well as of his large rivals, who are also seeking to expand.

320. The comparison of the small with the large trader suggests the question at what rate tax is passed on, assuming it to be passed on at all. The rate of tax payable by the individual ranges, according to the size of his income, from less than 1*d.* in the £ to an amount which, under the present scale, ultimately approaches 10*s.* (Income Tax and Super-tax) in the £. No satisfactory answer has been given to this question by those who contend that the Income Tax is substantially passed on in prices. The dilemma is, of course, due to the fact that, if the high rates of tax are passed on, the smaller traders should find it easy to undercut and expand their turnover, since the enhanced price represents a differential bounty to them : it has not been alleged that such an effect actually exists.

321. It seems impossible to avoid the conclusion that in retail trade there can be very little shifting, except in retail luxury trades (especially the better-class shops). As regards the bulk of the country's retail trade, which provides food, drink, clothes, &c., for the great mass of the population, shifting of Income Tax must be insignificant.

322. Outside retail trade the conditions appear to be even less propitious to the trader who attempts to shift the tax. The following reasons, in particular, may be adduced :—

(*a*) the average merchant or manufacturer is usually more alive to the advantages of expansion (which normally means lower prices) than the average retailer;

(*b*) he is more sensitive to foreign competition;

(*c*) he has largely to sell to expert buyers, who closely watch the movement of prices, whereas the retailer caters directly for members of the public, who, in general, have much less knowledge and enterprise, and are much more limited by locality;

(*d*) he has to compete with the public limited company (which has comparatively little motive to shift Income Tax) much more than the retailer; for, while most of the retail trade is done by private traders, much the larger part of other trade is done by public companies.

323. There can, it seems, be little or no foundation for the idea that, in the earlier stages of production, Income Tax is passed on, in a snowball process, from one trader to another. If a particular trader does make an injudicious purchase, allowing the vendor to pass some of his Income Tax on to him, competition will probably prevent him from raising his price correspondingly.

Finally, it may be noted that, according to the quantity theory of money, the general price level, given a certain constant volume of production, must depend on the quantity of purchasing power—money and deposits—and the velocity with which it circulates. An increase in the Income Tax could only enable traders in general to put up their prices, if at the same time it caused an expansion of currency or a more rapid circulation of money, enabling the prices to be paid. It is difficult to conceive how this could happen.

324. *Conclusion.*—We conclude that the broad economic argument is true over practically the whole field and for practically the whole of the time, any exceptions being local or temporary and insufficient to invalidate it.

SUB-SECTION IV: EFFECTS OF THE INCOME TAX.

Introductory.

325. We have just discussed the incidence of the Income Tax. We have been unable to escape the conclusion that the incidence, with unimportant exceptions, is upon the payer of the tax or, in the case of income taxed at the source, the recipient of the income: it is not shifted on to any other person, however widely the ultimate and indirect effects of the tax may be felt.

This conclusion indicates that the primary effects of the Income Tax are to be found in its action upon the restricted class of Income Tax payers, some two-and-a-half millions of single or married persons. We propose to examine the tax here in relation to those immediately concerned, with special reference to industry and trade, confining ourselves as far as possible to the broad effects of the existing system.

326. If the Income Tax is considered apart from the way in which the revenue from it is applied, its principal effects may be classed broadly under the following heads:—

I. The tax affects the economic capacity of the taxpayer:

(i) directly, it diminishes the amount available to him for spending or saving;

(ii) indirectly, through this action, it may limit the scope for his energy, initiative, &c.

II. The tax may affect the economic behaviour of the taxpayer:

(i) it may influence him in the allocation of his net income or profits between spending and saving;

(ii) it may influence him in the direction in which he employs his savings;

(iii) it may influence him in the exercise of energy, initiative, &c.

The first class of effects may be called the physical, the second the psychological. It will be observed that each is related both to saving (and its correlative, purchasing power), and to enterprise.

327. In reality these various effects commonly merge into one another. It is, however, desirable to distinguish them for the sake of clearness, and the analysis we have made will serve as a point of reference to which any part of the following discussion can be related.

328. It may be desirable to take a further step in definition, by explaining our use of the term "saving" which is often employed ambiguously.

The amount which a man saves depends on the amount of his income and the amount of his outgoings. He may add to the amount of his savings either by increasing the former or by cutting down the latter, so far as they are within his control. In other words, he may produce more or he may consume less, and the result on his cash savings may be exactly the same. It is quite common therefore to look on the making of income as if it were merely part of the process of saving : anything that deters a man from effort is sometimes said to have a deterrent effect on his saving.

This way of speaking blurs the distinction between saving and enterprise. When a man is working, he is not directly engaged in saving, but in producing ; and it is a fallacy to make production wholly subordinate to saving, as if saving were a supreme end in itself. In discussing the effect of Income Tax on business, the two aspects, production and saving, have to be kept clear. We, therefore, confine our use of the term " saving " (in the singular) to the setting aside, out of income *which has been made*, of a surplus over private expenditure. By so doing, we hope to prevent confusion between saving and enterprise, understanding by the latter the qualities of energy, initiative, &c., that go directly to the *making* of income, and that in some degree determine the particular use to which savings are applied.

Again, it is necessary to distinguish two objects of saving. A man may save in order to meet his tax liability and he may save in order to invest. Thus, if a man with a fixed income saves an additional £50 because his Income Tax liability has increased by £150, the tax may be called favourable to saving in the sense that it has caused him to spend £50 less. At the same time, it is unfavourable in the sense that it has reduced by £100 the amount he would otherwise have invested.

329. The natural order of discussion will perhaps be to deal first with the individual Income Tax payer, who, after all, is at the bottom of all organisations affected by the tax, then with the public limited company, and lastly with the private business. In the first section dealing with the individual, we will not consider him in his capacity as personally engaged in the exercise of trade or business. We will examine only how the tax influences the services of the employee and the professional man to the community ; how it acts upon the standard of living ; and how it affects the individual as an investor.

From consideration of the individual as an investor we pass by a natural transition to the public joint stock company; for, as investor, the individual is at once linked up with the public company, whose capital he supplies. It is the mark of the public company that the ownership and the business management are in different hands. In the private business, with which we shall deal last, the same persons are responsible both for the supply of capital (other than loan capital) and for the management. Thus the private business, whether individual trader, partnership or private company, is in a sense the more completely unified trade organism.

It may be convenient here to set out the framework of our discussion.

	Paragraphs.
I. Income Tax and the Individual:	
(i) The principle of progressive income taxation	330-333
(ii) (*a*) The post-war rates of tax and graduation	334-341
(*b*) Residence abroad to avoid tax	342
(iii) Effect of the Income Tax on the work and enterprise of the employee and professional man	343-350
(iv) The weight of the Income Tax and the standard of living	351-364
(v) The effect of the Income Tax on saving ...	365-377
II. Income Tax and the Public Joint Stock Company:	
(i) The supply of capital from the public ...	378-391
(ii) Company reserves	392-402
(iii) Enterprise of companies	403-404
(iv) Transfer of residence abroad, and allied effects	405-408
III. Income Tax and the Private Business:	
(i) The classes of private business and their distinction from the public company...	409-411
(ii) Comparison of the private business with the profession, &c.	412-415
(iii) The physical effect of the Income Tax on saving and enterprise	416-422
(iv) The psychological effect of the Income Tax on saving and enterprise ...	423-434
(v) Transfer of residence abroad and allied effects	435-436
IV. Summary of main conclusions	437-451

I.—INCOME TAX AND THE INDIVIDUAL.

(i) *The Principle of Progressive Income Taxation.*

330. The present system of differentiation and graduation of the British Income Tax dates from the Finance Act, 1920,

and owes its being to the Royal Commission on the Income Tax, which was appointed in 1919. In Appendix VIII we quote from the 64th Report of the Commissioners of Inland Revenue (Cmd. 1436), an extract from the account there given of the present system, as compared with the system which it superseded. We need not here enlarge upon this account; further information may be found in the Report of the Royal Commission on the Income Tax (Cmd. 615).

331. The first thing that strikes the eye in any table, such as those in Appendix XIII, comparing the effective rates of Income Tax and Super-tax before and since 1914-15, is that the graduation has become far more progressive. For a simple example, we may cite one or two figures relating to bachelors with investment incomes of different sizes; in 1913-14, when the standard rate of tax was 1*s.* 2*d.* in the pound, the same effective rate of 1*s.* 2*d.* was payable on any income between £800 and £5,000, while a rate of less than 1*s.* 8*d.* was payable on £100,000; in 1925-26, with a standard rate of 4*s.* in the pound, the effective rate progresses from 2*s.* 9*d.* for an income of £800 to 4*s.* 8½*d.* for one of £5,000, and to 9s. 5½*d.* for one of £100,000.

Steep graduation is so much a mark of the existing Income Tax that we must, at the outset, briefly consider the principle which underlies it.

332. Progressive taxation of income is justified, in the main, by the general rule that the marginal utility of income to the individual diminishes as the income grows. For instance, the last pound of an income of £10,000 has less personal utility than the last pound of an income of £2,000; consequently, it has greater capacity to bear taxation.

The rule is only valid in a general way. It is impossible to refine upon it and to say how much the utility decreases between any two points. So far as differences of individual taste and outlook can be ignored, it may no doubt be said that the utility of the last pound diminishes rather rapidly in the early increments of income, after the essential needs of life have been satisfied; then the rate of diminution tends to be slower, as the distinction between bare sufficiency and elementary comfort gives way to the slighter distinctions between lesser and greater comfort, and between comfort and luxury.

In actual fact, however, the value of money depends to a very great extent on individual outlook, on family responsibility and on social standards. There cannot be any uniform rate of diminution; the marginal utility to the man with, say, £600 may quite frequently be greater than to the man with £400. All that can be said is that normally the utility of income tends to diminish, and its taxability *pari passu* to increase, and that, on the whole, the process will be first at a more rapid and then at a slower rate. In the matter of taxation the State is bound

to take a more or less objective standard; it has to regulate its policy largely by reference to the normal case.

333. But there is a complementary aspect which imposes a check on the application of the ability to pay principle. Money in the free disposition of the citizen has a utility to the State as well as to himself. Saved and invested, it supplies the financial and industrial needs of the community. From this point of view, it cannot be said that there is diminishing utility in the individual's income. The utility, in fact, only begins when the income is sufficient to leave a margin over necessary expenditure; in other words, the special utility to the community only begins, when the greatest utility to the individual has creased. The larger the increase, the more room is there for saving; and the State, when putting a heavy tax on incomes with the greater margin, has to consider the risk of doing too much damage to savings.

(ii) (a) *The Post-war Rates of Tax and Graduation.*

334. *General.*—The standard rate of tax, and the estimated total net produce of the Income Tax and the Super-tax for the six years 1920-21 to 1925-26 were as follows :—

Year.	Standard Rate of Income Tax	Net Produce of Income Tax	Net Produce of Super-tax.	Total Net Produce.
		£	£	£
1920–21 ...	6*s.* in the £	353,219,573	70,800,000	424,019,573
1921–22 ...	6*s.* „	345,963,237	74,100,000	420 063,237
1922–23 ...	5*s.* „	294,994,186	62,300,000	357,294,186
1923–24 ...	4*s.* 6*d.* „	262,877,254	63,500,000	326,377,254
1924–25 ...	4*s.* 6*d.* „	265,000,000	62,000,000	327,000,000
1925–26 ...	4*s.* „	240,000.000	55,000,000	295,000,000

Under the system of graduation in force over these years, reliefs from tax have not depended as they did formerly on the limits within which the individual's income has fallen. Consequently, the administration of the tax has not provided data for an estimate of the proportion contributed to the total yield by incomes of different sizes. A roughly approximate idea may, however, be obtained from figures which were prepared by the Board of Inland Revenue for the year 1919-20, and which are reproduced in the table in Appendix XIV to this Report. The graduation for 1919-20, although less evenly adjusted to increases of income, was not dissimilar in general effect (as may be seen from the graphs in Appendix XIII) to that of succeeding years.

For 1919-20 the normal rate of Income Tax was 6*s.* in the pound; the net produce of the tax (including the Super-tax for the corresponding year 1920-21) was £403,055,563. It should be remembered that, as regards trade, the figures repre-

sent the average profits of the years 1916 to 1918, after deduction of Excess Profits Duty, but for which they would have been a great deal higher.

335. The table in Appendix XIV conveys a two-fold impression—the high yield on the large incomes, and the inequality of the distribution of income even within the limits of the Income Tax paying classes. The same impression is given, in greater or less degree, however the figures of the table may be grouped; the following arrangement will perhaps be interesting :—

1919-20.

Class of Income.	*Number of chargeable incomes.*	*Total net produce (Income Tax and Super-tax).*
		£
Not exceeding £500 ...	3,337,000	27,863,761
Exceeding £500 and not exceeding £1,000	330,510	32,053,223
Exceeding £1,000 and not exceeding £1,500	98,430	23,912,233
Exceeding £1,500 and not exceeding £2,000	44,440	18,163,440
Not exceeding £2,000 ...	3,810,380	101,992,657
Exceeding £2,000 and not exceeding £10,000 ...	79,350	103,537,906
Exceeding £10,000	10,270	120,725,000

336. When the tables of effective rates and the graphs in Appendix XIII are examined, it will be noticed that, with minor exceptions, the graduation becomes less steep, the higher the range of income. This is inevitable; an ascent continued from any point on the scale at a progressive steepening of a few pence in the pound per hundred pounds would soon result in the perpendicular wall of 20*s.* in the pound being reached. Moreover, a slackening of the rate of progression accords with theory, since we have seen (*para.* 332) that, as the individual's income grows, its taxability tends to increase first at a more rapid and then at a slower rate.

Nevertheless, the steepness of the graduation in the lower part of the scale, and the comparative slightness of the increase for incomes above, say, £8,000 or £10,000, and particularly for the highest incomes, is striking. It produces a first impression quite different from that conveyed by the absolute figures of yield quoted in the preceding paragraph. A closer scrutiny of the Income Tax scale appears to be needed. It will be convenient to divide incomes up into three groups, those not exceeding £500, those between £500 and £2,000, and those exceeding £2,000.

337. For details relating to the amounts and effective rates of tax on various incomes for the post-war years, reference is made to Appendix XIII. We will confine ourselves here to a few figures relating to 1925-26, which also apply to 1926-27.

338. *Incomes up to* £500.—The effective exemption limit for 1925-26 varied as follows, according to the circumstances indicated :—

Single person.		Married person without children.		Married person with 3 children.	
All investment income.	All earned income.	All investment income.	All earned income.	All investment income.	All earned income.
£	£	£	£	£	£
135	162	225	270	315	378

The income point above which the full standard rate of 4*s.* in the pound began to be chargeable, instead of the half-rate of 2*s.*, is as follows under each of the above heads :—

£	£	£	£	£	£
360	432	450	540	540	648

339. The table below gives the amount of tax payable on certain incomes up to £500 :—

Total income.	Single person.		Married person without children.		Married person with 3 children.	
	All investment income.	All earned income.	All investment income	All earned income.	All investment income.	All earned income.
£	£ *s.* *d.*	£ *s.* *d.*	£ *s.* *d.*	£ *s.* *d.*	£ *s.* *d.*	£ *s.* *d.*
200	6 10 0	3 3 4	Nil.	Nil.	Nil.	Nil.
250	11 10 0	7 6 8	2 10 0	Nil.	Nil.	Nil.
300	16 10 0	11 10 0	7 10 0	2 10 0	Nil.	Nil.
350	21 10 0	15 13 4	12 10 0	6 13 4	3 10 0	Nil.
400	30 10 0	19 16 8	17 10 0	10 16 8	8 10 0	1 16 8
450	40 10 0	25 10 0	22 10 0	15 0 0	13 10 0	6 0 0
500	50 10 0	33 16 8	32 10 0	19 3 4	18 10 0	10 3 4

It is noticeable how great a difference is made in this range of incomes by the allowances to the married man and by the earned income relief.

From the point where the full standard rate begins to be chargeable, the increase in the weight of tax naturally becomes more marked. The point is not reached in the last three columns.

340. *Incomes between* £500 *and* £2,000.—The married man with three children pays the full rate of tax on each pound of

taxable income above £648. From that point onwards, the family relief which he enjoys is exactly double that of the married man without children. It will be sufficient, therefore, in continuing the table given in the last paragraph, to take the case of the single person and of the married person with a family of three.

Total income.	Single person.		Married person with 3 children.	
	All investment income.	All earned income.	All investment income.	All earned income.
£	£ s. d.	£ s. d.	£ s. d.	£ s. d.
600	70 10 0	50 10 0	34 10 0	18 10 0
800	110 10 0	83 16 8	74 10 0	47 16 8
1,000	150 10 0	117 3 4	114 10 0	81 3 4
1,250	200 10 0	158 16 8	164 10 0	122 16 8
1,500	250 10 0	200 10 0	214 10 0	164 10 0
1,750	300 10 0	250 10 0	264 10 0	214 10 0
2,000	350 10 0	300 10 0	314 10 0	264 10 0

This table brings out a contrast between the family allowances and the earned income relief.

It will be observed that the full family relief enjoyed is £36 tax, and that this remains stationary as the income grows; it is the same for £2,000 as for £800.

On the other hand, the earned income relief increases in proportion to the amount of earned income (£3 6*s.* 8*d.* for each additional £100 of income from £648 onwards) until the maximum allowance of £50 tax is reached at an income, all earned, of £1,500.

It may be added that, until Super-tax begins to be chargeable, progression in the rate of tax depends solely on the increasing proportion of the taxable income charged at the full standard rate.

As will be seen from the tables of effective rates in Appendix XIII, this results in a slackening of the rate of progression, particularly in the incomes nearer to £2,000. Thus the graduation for investment income is relatively rather lenient between, say, £1,500 and £2,000. As regards earned income, however, the progression was improved in 1925-26 by altering the point at which the maximum differentiation is allowed from £2,000 to £1,500. The following result is found :—

Single Taxpayer.

Income.	*Effective rate, if all investment.*	*Effective rate, if all earned.*
£	*s. d.*	*s. d.*
1,000	3 0	2 4
1,500	3 4	2 8
2,000	3 6	3 0

341. *Incomes from £2,000 upwards.*—On the recommendation of the Royal Commission on the Income Tax, the point at which liability to Super-tax commences was in 1920-21 lowered from £2,500 to the existing limit of £2,000. The duty is charged according to a scale of graduated rates, applicable to successive increments or "slices" of income (*see Appendix* VIII). The scale remained unaltered from 1920-21 onwards, until reductions were made by the Finance Act, 1925.

The family reliefs remain stationary throughout at £18 tax in respect of the individual's wife, and £18 tax in respect of three children. The earned income relief also remains stationary at £50 tax.

We may therefore confine the rest of our illustrative table to the single person whose income is all investment income. We give both the amounts of tax and the effective rates:—

Total Income.	Single Person whose Income is all Investment Income.							
	Income Tax.			Super-tax.			Total.	
							Amount.	Effective Rate.
£	£	s.	d.	£	s.	d.	£ s. d.	s. d.
2,500	450	10	0	18	15	0	469 5 0	3 9
3,000	550	10	0	43	15	0	594 5 0	3 11½
3,500	650	10	0	81	5	0	731 15 0	4 2
4,000	750	10	0	118	15	0	869 5 0	4 4
6,000	1,150	10	0	381	5	0	1,531 15 0	5 1½
8,000	1,550	10	0	731	5	0	2,281 15 0	5 8½
10,000	1,950	10	0	1,131	5	0	3,081 15 0	6 2
20,000	3,950	10	0	3,506	5	0	7,456 15 0	7 5½
50,000	9,950	10	0	12,256	5	0	22,206 15 0	8 10½
100,000	19,950	10	0	27,256	5	0	47,206 15 0	9 5½
150,000	29,950	10	0	42,256	5	0	72,206 15 0	9 7½

It will be seen that the effective rate of Income Tax and Super-tax combined progresses very steadily until the income of £6,000 is reached. The progression then declines, moderately at first and afterwards more decidedly, until the total tax chargeable on £100,000 is only 7*d.* in the pound more than that on £50,000, and that on £150,000 is only 2*d.* in the pound more than that on £100,000.

(ii) (b) *Residence abroad to avoid tax.*

342. Before tracing the various effects of the post-war Income Tax and Super-tax as they fall upon the taxpayer, we may briefly refer to the question how far the weight of taxation has led individuals to transfer their residence to other countries in order to escape part or all of their liability. In the general

evidence we received there was little reference to change of residence by individuals as distinct from business concerns. Among witnesses who mentioned it were the Association of British Chambers of Commerce (*Ev., p.* 290; *E. in C.:* 49), the Accountant Societies (*E. in C.;* 33), and Mr. McKenna, who alluded to a current opinion that the number of people living abroad on this account was now very large (Q. 1908-9). It is difficult from individual impressions to gauge the extent of the movement abroad in order to avoid tax, especially when the comparative cheapness of living in countries with depreciated currencies has been an obvious inducement. We received a note from the Board of Inland Revenue on the transfer of residence abroad by business concerns and by individuals, which we print as Appendix XVIII. We deal later with business concerns (*paras.* 405-8 and 435-6). As regards movement by individuals, it appears from the Board's note that, while they have found it to require special attention, it has not reached any important dimensions.

(iii) *Effect of the Income Tax on the work and enterprise of the employee and professional man.*

343. *General.*—With regard to the effect of the tax on work and enterprise, we shall have more ground for discussion when dealing with the individual engaged in trade (*cf. para.* 416 *et seq.*), whom, in his capacity as such, we are at present excluding from consideration. We have here to look at the case of the wage-earner, the employee generally and the professional man.

These benefit in various degrees from the Government expenditure to which the Income Tax revenue contributes. Thus, especially in the lower ranges of liability, the individual and his family may benefit directly from the expenditure on health, pensions, education, etc. To an increasing extent in the higher ranges they may benefit from payment of interest on the debt. Such forms of Government expenditure take their part in creating the stability and confidence essential to enterprise. Apart from these general considerations, the psychological effect of the tax may be viewed without regard to the ways in which the revenue is applied. To all intents and purposes, what matters is the burden of the tax payment as immediately felt.

344. *Incomes up to* £500.—Between the effective exemption limit and £500 the utility of each additional pound of income that can be earned is high, and the tax upon each pound is only 1*s.* 8*d.*, until the income-point at which the full standard rate comes into play. In 1925-26 that point is reached at £432 in the case of the single man, and £540 in the case of the married man without children. With tax at this rate, the normal individual will not choose to refrain from work and diminish his income, simply in order to escape the resulting liability.

345. *Incomes between* £500 *and* £2,000.—The effect of the Income Tax, so far as it concerns the employee working for a fixed salary, is largely neutral. Such an employee is not, like the trader, in a position to measure more or less effort against the immediate prospect of more or less reward; he has not the same reason to debate how far, with such and such a tax, it will pay him to work hard.

It may be asked, however, whether the Income Tax will not make him less keen to work for a rise in salary. The tax, it is clear, has a double effect: on the one hand, by its inroad into present salary, it makes an increment all the more to be desired; on the other hand, it lowers the net money value of any increment. Thus, a married man with three children earning £1,000 pays £81 3*s.* 4*d.* under the 1925-26 scale, leaving him a net £918 16*s.* 8*d.*; an additional £100 would mean a net benefit to him of £83 6*s.* 8*d.* The question is whether an extra £83 will be worth less in his eyes than £100 would be, if there were no Income Tax and he had a net £1,000. The operation of the tax in diminishing his present income is the thing he realises most clearly, and on balance we doubt whether there can be any adverse effect on his work and enterprise. If there is any general effect of this kind on employees with fixed salaries, it is unimportant.

346. A word must be said as to the employee working partly or wholly on a commission basis—a form of remuneration in itself generally conducive to enterprise. We are not at the moment thinking of the managing heads of companies, whom we shall consider later (*para.* 403), but rather of subordinate officers, salesmen, commercial travellers, etc.

An employee with a fluctuating income, so long as it does not rise into the area liable to Super-tax, does not suffer any more severely than a person with a steady salary. Thus a single man chargeable on earnings of £500 and £1,500 in two successive years will, under the 1925-26 scale, pay £234 6s. 8d in both years taken together; this is precisely the same amount as it would be if his earnings were £1,000 each year. On this score then he is not prejudiced.

A man on a commission basis has doubtless more occasion to balance effort against the reward of effort than a man with a fixed salary. But, in general, we do not think that a man in the middle range of incomes, who has experience of ups and downs, will be deterred by an Income Tax of the existing dimensions from seizing every chance and making as large a gross profit as he can in a good year.

347. The professional man remains to be considered. He is open to the psychological influence of the Income Tax, since, being his own master, he is free to take up or decline work according to his judgment of whether it is worth while. To a

certain extent then he may be deterred by the tax. On the other hand he will very often be set on reaching or maintaining a particular standard of living, and will work harder if the Income Tax makes it necessary for him to do so in order to achieve his object. Increments of income between £500 and £2,000 continue throughout to be of large value, particularly to the married individual with heavy commitments. Apart from the professional man's ambition or pride in his work, we find it difficult to believe, on purely financial grounds, that the Income Tax will be a potent factor in making him less ready to work or to sacrifice his leisure.

348. The tax will, however, set up a tendency for a certain class of small opportunities to pass into the hands of the less well-off, including the younger men who have yet to establish their reputations. To the lawyer or doctor who is earning something in the vicinity of £2,000, an extra piece of work for a fee of £100 will be less tempting than to another man who is making £500 or £600. A 5*s*. or 4*s*. Income Tax, curtailing the fee by one-fourth or one-fifth, may turn the scales against the wealthier man taking up the work. This tendency will be operative to some extent within the limits of the incomes we are considering. It will, however, be more effective in transferring work downwards from the higher group of incomes : for in that group not only will the marginal utility of income further diminish but the Super-tax will further reduce the net value of the fee.

349. *Incomes from* £2,000 *upwards.*—When a man is earning a large fixed salary, the Income Tax is more likely to impel him to seek a higher-paid post than to damp down his energy. When the salary is fluctuating, the tax may hit him rather more severely; thus under the scale for 1925-26 an income of £4,000 and £10,000 in two successive years pays £138 more in tax than an income for each year of £7,000. The tax may have a slight tendency to depress initiative, although it will sometimes have the reverse effect. It is important to remember that the case of the employee is very different from that of the trader, in that normally he has not got to face the possibility of actual loss.

As regards the professional man, there will be the tendency which we have noted to avoid a marginal amount of extra work and trouble which would be undertaken but for the tax. Where, however, either large amounts of money or important issues of any kind are at stake, we think the effect will be small. It is widely true that men who rise to eminence in the professions are impelled by motives other than financial to pursue their work to the full extent of their capacity.

350. *Conclusion.*—Over the whole field of income we conclude that the Income Tax borne by employees and by professional men has had no important effect on their work and enterprise. It does not deter them from effort in such a way as to affect materially their income, that is to say, their potential standards

of living and saving. Any effect it may have had in the early post-war years will have partially worn off, for people have become more accustomed to a high level of tax, and moreover rates of tax have been reduced very substantially.

(iv) *The weight of the Income Tax and the standard of living.*

351. *General.*—In our discussion of the general standard of living, we concluded (*para.* 43) that the available evidence, while very incomplete, appeared on the average to indicate a maintenance of the wage-earner's pre-war position, or perhaps a slight improvement upon it. The problem arose how to account for this, when it was clear that total production had fallen : we suggested, as a possible contributing cause, the effect of highly progressive income taxation on the consumption of other classes.

352. *Incomes up to* £500.—We do not think that the Income Tax, at the point where it begins to be charged, presses upon the level of subsistence. The effective exemption limits in force for 1920-21 to 1924-25 were as recommended by the Royal Commission on the Income Tax. The Commission recognised the existence of some practical connection between the cost of living and taxable capacity, but in view of " the necessity for having a fairly fixed and constant point at which Income Tax should first attach," they recommended that the limits proposed " should be maintained until there is a substantial change in the cost of living, and that they should not fluctuate from year to year, but should be altered only at considerable intervals of time " (Cmd. 615 ; para. 247).

While the cost of living has fallen since 1920 to a substantially lower level, the exemption limits remained unaltered until 1925-26, when the only alteration was in favour of the taxpayer, increasing the earned income relief. The effective exemption limits for the unmarried wage-earner and for the married wage-earner without children were £150 and £250 respectively for the years 1920-21 to 1924-25. For 1925-26 they were raised to £162 and £270, and it may be noted that these figures are equal to about £230 and £385 in terms of the 1920 value of money.

353. As shown in paragraph 339, the weight of the tax becomes more considerable as an income of £500 is approached. The married taxpayer with earned income receives, however, a large measure of relief, and relatively to the single taxpayer is in a far better position than before the War. The single taxpayer is much more heavily taxed than in 1913-14. We do not think the charge on him oppressive, but there may always be hard individual circumstances causing any payment of tax to be severely felt. The exceptional cases would occur not only among earners but also among persons living on fixed investment incomes, e.g., retired persons and widows. The charge for 1925-26 on an investment income of £500 would be £50 10*s.* 0*d.*, unless the taxpayer had reached the age of 65 : in the latter case it would

be only £33 16*s.* 8*d.*, owing to a special relief for persons of 65 and upwards with small incomes introduced in the Finance Act, 1925.

354. In considering the total effect of the Income Tax on this range of incomes, it is to be noted (*cf. Appendix* XIV) that for 1919-20 incomes up to £500 yielded about 8¼ per cent. of the total Income Tax revenue (including the tax on non-personal income, but excluding Super-tax). There are no corresponding figures for later years, but the numbers of liable incomes up to £500 have dropped considerably, and more generous allowances have been granted : it may therefore be presumed that these incomes have recently made a contribution of distinctly less than 8¼ per cent. Probably they are now paying less than £15 millions.

Against this amount have to be set so much of the debt interest and so much of the benefits of social expenditure received by taxpayers in this class as may be attributed to the Income Tax revenue as a whole. Even if a high proportion of the Income Tax paid by them comes out of money which would have been spent on consumption, it does not appear that the total effect of the tax on the standard of living of persons with incomes up to £500 can be considerable.

355. *Incomes between* £500 *and* £2,000.—The graduation continues to be steep, though it becomes markedly less so towards the £2,000 limit. So far, however, as the unmarried taxpayer is concerned, the post-war scale does not generally appear to have been burdensome, and the reduction of the standard rate to 4*s.* has eased it very much.

356. For 1920-21 to 1924-25 the earned income relief consisted in the allowance of a deduction of one-tenth of the earned income for assessment purposes, with a maximum for any individual of £200 : for 1925-26 the deduction was one-sixth and the maximum £250.

The relief, although substantial, does not measure adequately the difference in ability to pay between pure earned income (or income earned by the present personal effort of the taxpayer), and pure investment income (or income drawn by the taxpayer from capital wealth to the creation of which he has contributed nothing). In fact the character of income varies indefinitely between these extremes : there is normally, for example, a larger capital element in the earned income of the trader than in that of the professional man, although this is more marked in the case of incomes above £2,000. In a general Income Tax, relief in respect of earned income cannot possibly achieve perfect equity between individuals whose incomes are in different degrees earned. This fact tells in favour of limiting the relief to a moderate amount. Nevertheless there would be a good case for increasing the difference in the treatment of earned and investment income as affecting incomes in this range, were it not for

the difficulty in regard to income from the taxpayer's own invested savings. Unfortunately, it is not feasible to analyse out that portion of an individual's capital which represents his own personal effort. If it could be done, the income yielded by it might justly be taxed at a lower rate than pure investment income, although the claim to relief would be less strong than in the case of current earnings, since the income would have ceased to be precarious in the same sense.

357. It must be borne in mind that the differentiation made by the Income Tax between earned and investment income is supplemented by the death duties (*para.* 476). Seen in this relation, the Income Tax relief is less open to the charge of being inadequate.

358. The family allowances, before they were remodelled in 1920 in accordance with the proposals of the Royal Commission on the Income Tax, were confined to incomes not exceeding £1,000. This limitation has been removed. But the allowances, as stated in paragraph 340, do not expand with the income, as the earned income relief does. From an income of £700 onwards (*cf. table in para.* 340), whether investment income or earned income, the increments of tax per £100 are exactly the same for the single person as for the married. Yet it seems clear that the marginal utility of increments of income continues to be distinctly lower for the single man than for the married; that is to say, the single man's ability to pay on each additional £100 is a good deal more than the married man's.

The existing Income Tax then falls more severely on the married man than on the single in this range of incomes. It may be argued that, if regard be paid solely to comparative ability to pay, the family allowances ought to vary to some extent with the size of the taxpayer's income, instead of being absolutely fixed.

359. Incomes between £500 and £2,000 form a numerous class: they were not far short of half a million in 1919-20. In the aggregate they must derive a large benefit from the Income Tax in the form of War Loan interest. They have, however, carried no light burden, and certainly the married man of moderate income has suffered heavily as compared with the generality of Income Tax payers, although, even when the standard rate was 5*s.* or 6*s.* in the pound, we do not suggest that he was pushed to the extreme limit of his endurance. How far the tax will actually have fallen on the standard of living depends on the sum of the reactions of individual payers. There will have been a widespread tendency to reduce consumption to some extent, and the effect will have been very definite in various types of case, e.g.,

(i) where the individual makes no effort to save at all, but habitually spends up to the limit of his net income; and would equally do so with a lower tax;

(ii) where the individual is committed to the payment of life insurance premiums, but would not save anything over and above those premiums, even if the tax were much lower;

(iii) where the individual, without being committed in this way, has a high standard of saving, and reduces his living expenses in order that the Income Tax may cut into his savings as little as possible;

(iv) where the individual aims at saving enough to produce a given net income after deduction of tax, and therefore tries to invest a larger gross sum than he would if the tax were lower.

In all these cases (of which only the last involves any increase of the individual's investment) the immediate standard of living will have suffered. Sometimes, especially in the first type of case, the only expenditure affected will have been of a definitely luxurious kind, but over the field as a whole the effect will have gone deeper. The married man with a moderate income will normally make a considerable effort to retrench in order to provide for his family's future. Over the whole of this range of incomes we think that the Income Tax, viewed as a separate factor, must have had a fairly strong tendency to depress the standard of living, even when allowance is made for that part of it which is merely transferred within the class in payment of debt interest.

360. *Incomes from £2,000 upwards.*—A large amount of the Income Tax and Super-tax paid by persons with incomes exceeding £2,000 comes back to themselves as a class in the form of War Loan interest. It is clear that this internal transfer does not diminish the aggregate real income of the class. It increases the income of the debt holder exactly as it decreases the income of the taxpayer. In relation to real income, therefore, the tax so applied is not onerous. So far as the debt interest of the Super-tax paying class is provided from the Income Tax paid by other classes, there is an actual increase of their income.

It must not be overlooked, of course, that, with lapse of time since the War, the personnel of the Income Tax paying class is changing. Those individuals who had large incomes, and especially those who made large profits, during the War, are in a different position from those who are making their careers now. The former, who might have been called upon for a larger tax contribution to the then current war expenditure, had instead the opportunity of investing in War Loan, and it is fair to regard their tax burden, both at the time and since, as having been eased by the fact that a large part of their tax has gone in payment of interest to themselves. This consideration does not apply with the same force to those who were not earning large profits during the War and who could not, therefore, have been called upon for a similar large tax contribution. They have made and saved money since those days, and the fact that they

may have been purchasers of War Loan instead of other stocks is no reason for regarding them as in a different or favoured category: they are in no better position than if they had bought railway stock.

361. Before the War, the principle of progression in income taxation had not been carried far. The result is that, under the post-war graduation, the burden on the incomes in the Super-tax range has been more largely increased than any other: this may be seen from the tables in Appendix XIII. Those of the well-to-do, whose incomes are no greater (or, it may be, are less) in purchasing power than before the War, have undoubtedly in many cases cut down expenditure: they have, for instance, sold their houses and taken smaller ones, and the heavy tax has in some degree been responsible. But these cases are no index to the effect of taxation on the well-to-do as a whole. In fact, their main relevance is not so much to taxation as to the distribution of wealth, and they indicate a shifting of wealth rather than a diminution.

362. Nevertheless it is to be surmised that the heavy taxation has had an appreciable effect on consumption, at least in the lower levels of income liable to Super-tax. The tax may here involve a substantial sacrifice in individual cases, if the income is specially precarious or the private responsibilities are heavy. The earned income relief, which is limited to £250 in terms of income and £50 in terms of tax, is in itself (i.e., when the Income Tax is viewed apart from the death duties—*for which cf. para.* 476) entirely inadequate to mark the difference in ability to pay between an income wholly earned and one consisting wholly of investments. Again, the taxability of a married man with children who has an income of £3,000 or £4,000 is still much less than that of a single man, although the difference in ability to pay relates to a widening circle of goods and services further away from the centre of essential needs.

363. With regard to the highest incomes, little need be said as to the effect of the tax on the taxpayer's personal standards. The important question is the effect on his savings. Were it not for the industrial aspect, the tax might on theoretical principle be increased to a point higher than it has reached. But the industrial aspect is vital: we are not, therefore, called upon to suggest up to what point graduation might fairly be carried, if only the personal aspect of the individual required consideration.

364. *Conclusion.*—In the lower and middle ranges of income those with fixed money incomes have in some cases suffered. Again in the middle range the tax has fallen with relative severity upon the married man.

Where the Income Tax is taken as a distinct factor, it has no doubt had an appreciable tendency to depress the standard of living of Income Tax payers as a class, but owing largely to the

fact that so much of the tax as provides for their debt interest is merely a transfer between themselves, the effect has been less than might have been anticipated from the large yield.

While, however, taxation for debt interest is itself a mere transfer, it covers up a deficiency of real income. It swells the nominal income of the community without adding to the resources on which the standards of living and saving depend. In other words, the community are not getting any real return on their War Loan investments, such as they would have obtained if no unproductive debt had been incurred and their savings had continued to flow into productive industry. This deficiency of real wealth producing its own income stands side by side with the Income Tax as a complementary cause limiting the power to spend and save.

It is of particular importance to bear this in mind when considering the wealthy classes who have to pay tax at a high rate towards the interest charge. The aggregate nominal income of persons liable to Super-tax is very roughly in the neighbourhood of £500,000,000. The part of this income which stands for debt interest paid by themselves to themselves does not represent any spending or saving power.

In speaking above of the tendency of the Income Tax, when "taken as a distinct factor," to depress the standard of living of the Income Tax paying class, we have in mind the slight counter tendency which appears to be set up by the indirect taxes (*cf. paras.* 668-70), when the present direction of Government expenditure is taken into account.

(v) *The effect of the Income Tax on saving.*

365. *Incomes up to* £500.—It is probable that a high proportion of the tax is paid out of money which would otherwise be spent on consumption. To this extent it does not reduce savings. Moreover, so far as the tax is applied in payment of debt interest to persons in a better position to save, it may be presumed that the effect on aggregate savings is actually beneficial. We would add, however, that we appreciate the special desirability of fostering savings in the poorer section of the community, and from this point of view anything that hinders their power to save is to be regretted.

366. *Incomes between* £500 *and* £2,000.—Here the Income Tax becomes much heavier (*cf. para.* 340). We have delineated (*para.* 359) four types of case in which the Income Tax either forces or induces people to curtail their living expenses. In this range of income it will be a rather uncommon result for people—as in type (iv)—to increase their savings, i.e., the amount they can invest. More frequently—as in types (i) and (ii)—savings will be unaffected. In the majority of cases —as in type (iii)—savings for investment will be reduced to some extent, in spite of any economies that may be made.

367. The incentive to economy is, we have noted, particularly strong in the case of the married taxpayer, who feels the pressure of the tax on his smaller margin for free spending or saving. With less ability to save than the bachelor, he has a stronger motive, regarding it as an obligation to provide for the maintenance of his family in case of his death, for the education of his children, and so on.

368. It may be granted that the Income Tax, by reducing the taxpayer's current income, inclines him to economise in order that his savings may suffer as little as possible; but it may still be asked whether he will not be deterred by the knowledge that, if he invests, he will have to suffer tax again on the proceeds. The answer depends on the outlook of the individual. The man with a moderate income normally thinks more about the capital sum he can accumulate than about the yearly interest. His main object being to lay by for future needs, the Income Tax will not enter deeply into his calculations. So far as life insurance is concerned, he is encouraged by the fact that he will get relief from tax in respect of his premiums; moreover, the incidence of the tax on the yield of those premiums, while they accumulate in the company's hands, is practically concealed from him.

369. In addition to insurance, a class of property for which the demand will be relatively inelastic is house property. The Estate Duty statistics show that the smaller estates contain a considerably higher proportion than do the larger, both of house property and of insurance policies; to these smaller estates we may more particularly relate the middle range of incomes. The following figures illustrate the distribution of property in estates from £100 to £5,000, and in the aggregate of all estates. They represent averages for three years, but the variation as between the years is little.

Average for 1921-22 *to* 1923-24 *of the Total Gross Capital Values of all property (Great Britain), and of the Capital Values of certain of the constituent parts.*

Range of Estates.		Total Gross Capital Values.	Policies of Insurance.	House Property and Business Premises.	Securities, Stocks and Shares.
Exceeding £ net.	Not exceeding £ net.	£ millions.	£ millions.	£ millions.	£ millions.
100	1,000	23·79	1·59	7·47	4·94
1,000	5,000	73·47	3·29	18·04	24·69
All Estates	... ...	471·09	14·52	69·56	230·95

When the combined figures are taken for the two classes of small estates, the value of the insurance policies and the house property together is about 31 per cent. of the total, while the value of securities, stocks and shares is about 30 per cent. For

all estates, insurance policies and house property account for less than 18 per cent. of the total values, while securities, etc., are not far short of 50 per cent.

370. For 1923-24 there are available for the first time details of the distribution of property for married and single decedents separately.

A table is given in Appendix XVIII which goes to support the natural expectation that the married will take out insurance policies a good deal more freely than the unmarried. If the figures for the two groups of estates up to £5,000 are taken together, it appears that out of a gross capital value of £35·2 millions left by married decedents, £3·4 millions consisted of insurance policies and £8·2 millions of securities, stocks and shares; for single decedents the gross capital values were £8·4 millions, of which only £0·35 millions consisted of insurance policies, while £3 millions were in securities, stocks and shares.

371. The inference from all these figures is that persons in the middle range of incomes from £500 to £2,000, and especially married men in this range, normally save and invest with a view to security more than with a view to becoming richer in the immediate future. It may be inferred, therefore, that the prospective tax on income from investments will not deter them from saving to any important extent.

372. On balance, we arrive at the result that the psychological effect of the Income Tax on incomes in the range from £500 to £2,000 will not be deterrent; it will be quite definitely in favour of reduced consumption. The increased effort to save for investment is, however, more than neutralised by the decreased capacity; the damage of the tax lies in its physical effect., i.e., in the direct diminution of the income out of which it is possible to put by savings. In estimating the force of this effect, full allowance must be made for the debt interest received by these incomes out of income taxation. But we think that the final resultant must have been a quite considerable loss of savings, especially in the earlier post-war years, when the rates of tax were at their highest.

373. *Incomes exceeding* £2,000.—It was suggested by Mr. P. D. Leake that "progressive taxation is based upon a principle which assumes that the natural desire and custom of all men is to spend their incomes for their own personal wants and pleasures." (*Ev.*, p. 332; *E. in C.*, 18). We cannot endorse this criticism. It is indeed correct to assume that standards of living and spending bear some relation to size of income, and this assumption is implicit in a progressive tax. But progressive taxation, unless carried to a violent extreme, does not imply any failure to recognise the complementary relation between size of income and amount of savings. The graduation now existing in this country, whether or no it has

proceeded too far in the ultimate interests of society, has certainly been checked by the fear of entrenching too heavily upon the essential supply of capital.

We may in this connection quote the Royal Commission on the Income Tax. After saying that, for reasons stated, they were not called upon to recommend any increase in the high taxation borne by Super-tax payers as a whole, and putting in a proviso that in any redistribution of the burden (so long as the standard rate of Income Tax remained unchanged), " the effective rate of tax on incomes up to, say, £8,000 should not be increased," they proceeded as follows : " Although from this point the effective rate of tax might be more steeply graduated, in view of the national disadvantages of progressively high rates of tax, there cannot safely be any substantial increase in rates until the highest incomes are reached " (Cmd. 615, para. 152). It is thus a consideration of the " national disadvantages " of extreme progression which has prevented the tax being carried to a higher point. This helps to explain the flattening of the curve at the top of the scale shown in the graphs in Appendix XIII.

374. The term " national disadvantages " alludes, of course, to the widespread effects of too great an inroad into savings. We have seen that in 1919-20—so far as that year can be taken as a guide—no less than £224 millions out of £326 millions of Income Tax revenue (including Super-tax) was attributable to incomes above £2,000, and that over £120 millions was attributable to those incomes (about 10,000 in number) which exceeded £10,000.

The figures may again be set out thus in relation to the aggregate actual income :—

1919-20.

Class of Income.	*Actual Income.*	*Net Produce of Income Tax (including Super-tax).*
£	£	£
2,000-10,000 ...	299,601,849 ...	103,537,906
Above 10,000 ...	241,100,000 ...	120,725,000

These figures relate to a time when the normal rate of Income Tax was 6*s.* in the pound. Even so the figures suggest, *prima facie*, a serious drain in the post-war period upon what has undoubtedly been in past times a great reservoir of savings. But the figures must not be taken at their full face value. Against them has to be set the very large amount of debt interest received by members of the Super-tax class. So far as this interest is provided out of Income Tax paid by other classes, there is an addition to the saving power of the Super-tax class. So far as it is provided out of tax paid by themselves, the tax itself—being a mere transfer—is not responsible for any diminution of saving power : it does however indicate a deficiency of saving power, as explained in paragraph 364.

375. The reduction of present income by the tax is less stimulating to effort than in incomes below £2,000, and the prospect of future taxation, so far as the income is saved, has a more deterrent effect.

It is true that the counter current of increased effort to save will still be appreciable, particularly in the incomes from £2,000 to, say, £10,000 and, as we shall see, in the case of very large private businesses. But the combination of Income Tax and of Super-tax at the rate applying to the top " slice " of the individual's income heavily reduces the net return on saving, and the wealthy investor is in general much influenced by the net return he can get.

376. The actual effect depends, as usual, on individual psychology, and it is difficult to say how far the taxes encourage either investment in non-income producing assets, such as works of art and jewels, or extravagant living. Possibly there is a danger of over-estimating these tendencies : the continued outflow to America of valuable pictures certainly does not support the idea of unnaturally stimulated competition from home buyers. As to general extravagance, we suspect that, so long as caution is an element in character, heavy taxation is more likely on the whole to discourage active effort and interest than to encourage recklessness. Besides, whatever may happen when an increase of taxation is first imposed, the reactions of the taxpayer generally tend to weaken within a few years, as he grows more used to the burden.

377. *Conclusion.*—The adverse effect of the Income Tax on saving for investment does not appear to be appreciable in amount, so far as concerns incomes up to £500. In the range from £500 to £2,000 it appears to be quite considerable, but to be checked by an increased effort to save. In the highest range the effect is more important.

Side by side with the Income Tax, and difficult to distinguish from it as a factor limiting the power to save, is the absence of any return to the community on moneys invested in the debt. This factor operates in all classes, but is particularly important in the Super-tax class (*cf. para.* 364).

When the two factors are taken together, the effect on savings is of real moment and, if it could be analysed out, would no doubt prove to be serious in the Super-tax range of incomes. But, as in the case of the standard of living, other factors are at work. While the death duties operate in the same direction, a counter-current—probably slight, but not to be ignored—appears to be set up by the Customs and Excise duties (*cf. para.* 668). We have seen that, in spite of heavy direct taxation, and in spite of efforts for a higher standard of living, the falling off in total savings, although very substantial, is not startling in amount, so far as the evidence indicates (*cf. para.* 60).

II.—INCOME TAX AND THE JOINT STOCK COMPANY.

(i) *The Supply of Capital from the Public.*

378. We have summarised in paragraphs 350 and 377 the conclusions we have so far reached (reserving the important case of the man engaged in private business) as to the effect of Income Tax on savings through its influence on enterprise and saving. "Savings" from the point of view of the investor constitute the "supply of capital" from the point of view of the public company. We have, therefore, already covered a great part of the enquiry which might be placed under the present head.

379. We have yet to consider, however, whether there is any material effect on the *direction* of investment, owing either:—

(i) to the redistribution of saveable income as between individuals.

(ii) to the reduction of the net yield on savings.

(iii) to the transfer of saving power from the company to the individual.

(iv) to the transfer of saving power from the general taxpayer to the rentier.

380. *Redistribution of saveable income.*—The Income Tax clearly levels down the higher incomes, although there is a counteracting movement so far as it is applied in payment of debt interest. Thus, to this extent, it redistributes saving power in favour of the moderate and lower incomes. There is some levelling tendency of this kind from the top to the bottom of the Income Tax scale.

Persons of moderate income, who as a class make a special effort to keep up the amount of their savings, have usually a preference for safe outlets and, as we have seen (*para.* 58), savings in the form of life assurance appear to have been maintained better than savings in general. The preference for safety becomes more marked in the case of the small incomes, as several witnesses mentioned: for briefly, as Lord Hunsdon said, "the poor are not justified in risking their money" (*E. in C.*; 5).

It seems clear that the levelling tendency of the tax must have an appreciable effect on the kind of stock in demand. So far as it operates, it must give at any rate a slight advantage to trustee stocks as compared with industrials: in the industrial field it must favour in some degree the less speculative issue.

381. *Reduction of the net yield on savings.*—The prospect of a reduced net yield will perhaps chiefly affect the wealthy investor who can spread his risks, and who can afford to put large sums into speculative enterprise. He will naturally pay much attention to the net return he can get on his money. The prospect of heavy taxation reducing his dividends will suggest the desirability of an increased gross return on his investments. On

the other hand, viewed as the consideration for facing a possible loss, a high return will be less tempting than it would be with a lighter tax.

382. Conflicting currents will thus be set up, and witnesses expressed varying views as to their relative strength. Very much depends on individual temperament. A distinction should no doubt be made between different degrees of risk: thus Sir Arthur Lowes Dickinson thought that the high tax might often encourage the wealthy investor to transfer from a gilt-edged 5 per cent. to less safe debentures, but that it would disincline him to embark his money on large hazards (Q. 3522-6). We think this view has considerable force. If it is correct, the prospective high tax will be rather favourable to industrials where the risk is only moderate. As regards the most risky type of enterprise, we think that the diminution of current income by the Income Tax and Super-tax, combined with the prospective diminution of any income from successful speculation, must on the whole have a definitely discouraging effect. It may be noted that, with a high Income Tax, the question of the relative attraction of speculative as compared with safe investment is not purely psychological. A speculative stock, if it is to attract capital, must offer a return over and above the gilt-edged rate of interest such as to provide an adequate premium for the general and specific risks of the business. Income Tax and Super-tax, when heavily increased, may so cut into the rich investor's return that the premium element is no longer sufficient, on an actuarial basis, to cover the valuation of possible loss. In such circumstances, unless the rate of return can be increased, capital from the wealthy class of speculators cannot in the long run continue to be attracted. Any taxation which unduly diminishes the reward of entrepreneurs for taking pioneer risks is in that respect a source of harm to the community.

At the same time it is possible to exaggerate the proportion of really speculative investment to be credited to the wealthy individual. We are here considering him not as conducting a business of his own, but as investing in the funds of public companies. Even in this connection, however, it is probably not without significance that the most risky type of enterprise is normally carried through by the public company, with funds subscribed by the general public, and not by the private business.

The effect on the wealthy investor of prospective high taxation is thus rather complex. On balance we are not inclined to think it unfavourable to industry. It is probably slightly beneficial as regards average industrials, while having some deterrent effect in relation to those with more extreme risks.

383. The moderate and the small investor are rather less likely to be influenced. The cautious at one end, and those in whom the speculative instinct is uppermost at the other, may as a rule be slightly confirmed in their natural bent. For the main body of investors, where an uncertain balance is held between

caution and speculation, the balance may be inclined either way. Mr. McKenna suggested that the man who has not got much money will sometimes be induced to speculate for an increase of capital on which no tax will be payable : he may choose to do this rather than to build up savings slowly at 5 per cent., when the net yield is reduced by a high Income Tax (Q. 1979 and 2015-7). This is undoubtedly true : but it is not possible to lay down any general rule, to which individual psychology will not provide frequent exceptions.

384. *Transfer from company to individual.*—We deal under a separate heading with the taxation of company reserves. Here, however, we must observe the effect it may have in diverting capital from one type of business to another. When the undistributed profits of industry are eaten into by taxation, it may be that a portion of the money so taken will find its way back into industry, so far at least as it is applied in service of the debt. But when the lesser-known business is compelled to go into the market to reinforce its capital, it will compete at a disadvantage with the business that has long been established and has wide connections. The result may be accentuated, in so far as the debt holder is more cautious than the average investor (either by nature, or by necessity as a trustee) and is less inclined to put money into little-known businesses.

This consideration has more importance for the private business (*cf. paras.* 420-2), but it is relevant also to the public company. Most witnesses agreed as to its force.

385. It is, of course, also possible that there may be a diversion of a more fundamental character. Professor Cannan did not think there was any important diversion within the field of industry : the suggestion of diversion to foreign stocks was, in his view, more alarming (Q. 818). Similarly, in relation to rapid debt repayment, Mr. Keynes, while thinking the suggestion as to internal diversion was true, was more inclined to stress the danger of money flowing into Colonial securities in preference to all types of English industrials (Q. 3974).

386. In the case of rapid debt repayment new factors come in. Under the present Sinking Fund system, however, we do not think there is any significant diversion of moneys abroad, nor, so far as the public company is concerned, any material diversion from the less-known to the better-known type.

387. *Transfer to the rentier.*—Some interesting views have been put before us regarding the transfer from the general taxpayer to the rentier involved in taxation for the service of the debt. These have mainly centred round the question of rapid debt repayment, but a common underlying opinion seems to be that the debt-holder or rentier is essentially a rather unskilled and unenterprising type. We have already indicated (*para.* 265) that we think it easy to exaggerate this idea. Mr. Layton, who

takes a moderate line in the matter and points out the extreme difficulty of getting any evidence upon it, quotes certain figures (*para.* 55), which analyse the new issues of the last few years, as tending " to confirm the general expectation that the public is playing for safety." He concludes that " the tax system by transferring wealth to the rentier class has had some small effect in diverting what savings there are into safe rather than into enterprising forms of investment " (*E. in C.*; 19). We ourselves doubt whether the transfer of income and capital to the debt-holder on its present scale—a transfer in which indirect as well as direct taxes play their part—has had any appreciable effect. We should be surprised if it has done more than balance the reduced saving power of many pre-war rentiers.

388. *Conclusion as to direction of investment.*—The figures quoted by Mr. Layton do to some extent suggest a playing for safety since the post-war boom (*cf. para.* 55). A good deal must, we think, be allowed to the lack of general business initiative in a period of depression. The Income Tax, in the various aspects which we have discussed in paragraphs 379-387, has, on balance, we think, put a certain check on adventure, but we would attribute to it a quite minor influence.

389. *Adequacy of supply.*—We should hesitate to say that the Income Tax has, in the last few years, actually made it difficult for industry to raise share capital. We should even hesitate to say that the deficiency of national income due to war expenditure (*cf. para.* 364) has made it difficult for industry to get the capital it wants. Various shades of opinion have been expressed by witnesses; altogether, the trend of the evidence does not point to any general or clearly-marked deficiency in relation to actual demand, although it naturally suggests that demand might be stimulated by more abundant, and therefore cheaper, capital. We agree largely with Mr. Hobson's summary of the situation; if there were " a considerable and secure revival of trade," it might be that " some shortage of capital in the real sense would be manifested; but at the present time to argue that there is any shortage of capital either for the operation of existing productive plant, or for the establishment of new productive plant, does not seem to me to be supported by any considerable body of evidence. Nor am I sure that, if that new capital could be got at a somewhat cheaper rate than is available at the present time, that degree of cheapness would make any large difference as regards the attainment of business in the markets of the world." (Q. 1552 (4).)

390. The possibility of shortage in the event of a trade revival must, we think, be considered seriously. Professor Scott suggested that " in the industrial progress that is to be anticipated one limiting influence is likely to be a scarcity of capital for the developments which will be necessary " (*E. in C.*; 11). This may even cause difficulty to industries which are at present very

depressed and have capital lying idle. The fact that the supply of capital may show no evident failure to meet the needs of the moment is no reason for complacency as to the future. At the same time, what is wanted is not a sudden trade boom but a gradual and steady revival, and such a revival might sufficiently feed itself. Indeed, the lack of a ready-made surplus of capital might actually do good service in checking an unhealthy rate of expansion.

391. *The foreign investor.*—A word should perhaps be added as to the foreign investor. Sir Felix Schuster (*Ev.*, p. 10; *E. in C.*: 9) and Mr. Brand (*E. in C.*: 8) were very definitely of opinion that the Income Tax deters the foreigner from investing in securities of this country; the latter, indeed, regarded the foreigner as practically prohibited altogether. Professor Pigou (*Ev.*, p. 41; *E. in C.*: 33) thought there was a presumption that he would be deterred.

As a rule, the foreigner will be liable to the taxation of his own country on his income from all investments, wherever placed. In order that the yield of a British investment may in itself be sufficient to attract him, it must compare favourably, after British Income Tax has been deducted, with the gross yield he can obtain at home. As regards gilt-edged investment, however, he has a wide field open to him in British Government securities free of tax to the non-resident.

It is clear that, with this exception, the British tax reduces the yield of British gilt-edged securities below the rate of interest generally ruling abroad. It practically amounts then to a prohibitive tariff, with preference in favour of British Government securities.

The Income Tax will also act as a strong deterrent in the case of investments which earn a varying rate of profit. Where, however, there is the prospect of a high gross yield, combined with relative safety, it may not be decisive.

(ii) *Company Reserves.*

392. *Dividend and reserve.*—An exceedingly important part of the national saving is undertaken by companies themselves. It is recognised as a rule of sound finance that a company should withhold some portion of current profits from distribution, putting the amount to reserve in order to strengthen and expand its business. Mr. McKenna suggested that it was a characteristic of English business to put back into reserve as much as possible (Q. 1807). To the extent that companies take this course they supply their own capital requirements. The saving, while effected on behalf of the shareholders, is done without any volition on their part; it is collective and impersonal.

393. A company bears Income Tax at the full standard rate on amounts put to reserve. There is no question of any additional charge by way of Super-tax, or of any reduction to a

lower effective rate by way of Income Tax repayment, such variations applying only to the individual taxpayer. It makes no difference to the rate borne by reserves whether the profits of the concern be large or small, and whether the shareholders be rich or poor.

394. *Reserve policy.*—Public companies derive a large amount of interest from holdings in war stock. This benefit must be set off against the damage of taxation. For clearness, however, we will omit this consideration for the moment, reverting to it shortly (*cf. para.* 401). First, we have to consider whether the Income Tax has any influence on the allocation of profits between dividend and reserve; several witnesses considered that the high tax inclined companies to distribute more than they could well afford in order to satisfy shareholders. There seemed to be a slight uncertainty on the question whether the object was to keep up a conventional gross rate of dividend, or to go further and meet a demand from the shareholder for a certain net yield after taxation. We may observe that an attempt to pay a precisely equal net dividend would be defeated by the fact that individual shareholders bear tax at different rates according to their income. In any case, we believe it to be exceptional for the investor to demand an increased rate of dividend specifically in order to compensate him for an increased liability to tax; when he exerts pressure, it will usually be on more general grounds.

The effort to maintain a gross rate of dividend is on a different footing. It may be observed that, where the capital has remained at the pre-war nominal amount, there should not in the normal case be any difficulty in keeping up a traditional gross rate of dividend, since in general profits have increased more or less in ratio to prices and represent a greater ratio on old capital. At the same time, the difficulty may occur in industries suffering great depression.

It is possible that in some cases the attempt to keep up a gross rate may have bad results; but the Income Tax can hardly be held responsible. It is well to be clear exactly what part the tax pays. Since the company, having paid Income Tax on its profits, recovers tax at the full rate on payment of dividends, it is no more expensive to pay out a given gross dividend when the standard rate is 6*s.* than when it is 1*s.*; the higher rate of tax merely means that a larger proportion of the gross dividend goes to the State, and a smaller proportion to the shareholder. The company itself is only affected by the tax on its undistributed profit; if the diminution of that profit has any influence on policy, it is likely rather to prompt the setting aside of larger gross amounts. This, we believe, it has done to a considerable extent.

395. On the whole question we agree with the view expressed by more than one witness—particularly by Mr. Beaumont Pease

(*E. in C.*; 19) and Mr. Gordon Selfridge (Q. 7119)—that, when a concern is well managed, it will not be deflected by high Income Tax from a sound policy in the matter of reserves.

As we have already seen in our general review of savings (*paras.* 48-53), the statistical evidence available does not show any sign of reserves having been sacrificed to dividends. It tends rather in the opposite direction; for it indicates that companies, regarded *en bloc*, have maintained their reserves even at the expense of dividends.

396. *Tax on reserves.*—We may pass then to consideration of the main point, i.e., the effect of the Income Tax as it falls upon the profit actually withheld from distribution. According to the Board of Inland Revenue's estimate (*cf. para.* 48), the aggregate of the gross sums retained out of profit by public and private companies amounted to £219 millions for 1922 and £217·5 millions for 1923 : the bulk of these totals would be attributable to public companies. The standard rate of Income Tax being 5*s.* in the pound in 1922-23, the total tax on undistributed profits was £54·8 millions, leaving a net saving in this form of £164·2 millions. With the standard rate at 4*s.* 6*d.* in 1923-24, the total tax was £49·1 millions and the net saving £168·4 millions.

For the year 1924 we received an estimate of the aggregate national savings from Mr. Coates, who put forward a figure of £500 millions (*para.* 47). The Board's figures of undistributed profits for 1922 and 1923 confirm the large part in the aggregate which Mr. Coates assigned to savings of this class, but they cannot be directly correlated with his estimate of aggregate savings, since they refer to different years. We have indicated that, with the deficient data available, we are disposed to think a figure of £450 millions to £500 millions represents the best estimate that can be made of national savings in the recent years of depression. The total, however, may doubtless have varied considerably from year to year. Again, as regards company savings, the Board of Inland Revenue entered a caveat that, although the figures of 1922 and 1923 happened to be about the same, it could not be assumed that they were typical of the post-war period generally.

397. The figures of taxation are impressive, as they are bound to be when a high rate of tax is applied to a great body of profits. The Exchequer, it will be noted, gains from the profits of a company being distributed, so far as the shareholders are members of the Super-tax class, and loses so far as they are entitled to exemption from Income Tax or are liable only at half the standard rate. It is impossible to say what would be the balance of loss or gain—perhaps gain is rather more likely—if all profits were distributed.

398. *Equity.*—The question whether it is right to tax at the standard rate has to be considered from several points of view—that of equity, that of the industrial interest of the community, that of the needs of the Exchequer, and that of the practicability

of any alternative. Later in our Report (*para.* 1016 *et seq.*) we refer briefly to the suggestion put forward by several witnesses that relief ought to be given. In the present context we confine ourselves to studying the tax as at present imposed.

The question of equity may be raised in two forms; one sets up a comparison between individual shareholders, the other between different businesses.

As regards the first it has only to be remarked that the company reserve is composed of the involuntary savings of shareholders with incomes of varying size. One may be liable at 8*s.* in the pound on the amount which he saves of his own free-will, out of income actually received : another may be liable at 2*s.* : a third may be exempt.

All three, as regards savings made by the company on their behalf, bear the same standard rate. But the man who is escaping Super-tax on his share is unaware of any benefit, and the man with an income not liable to Income Tax is not conscious of any hardship.

399. As between several businesses, the most interesting comparison is between the large company and the large private business. The question of equity is here bound up with the question of the community's advantage, for both concerns provide a valuable source of savings.

When the standard rate of Income Tax was 6*s.* in the pound, in 1920-21 and 1921-22, £50,000 allocated to reserve by a public company would have borne £15,000 tax. The same sum kept in the business by an individual trader (unmarried) with a total chargeable income of £150,000 would, as part of that income, have borne Income Tax and Super-tax amounting to £30,000. In 1925-26 the tax in the first case would be £10,000 and in the second £25,000. When the figures are compared, it is seen that the public company has not only benefited absolutely by the reduction of the standard rate from 6*s.* to 4*s.*, but is also in a better position relatively to the big individual trader, the Super-tax charge on the latter having remained almost unaltered.

Judged by the above comparison, the company appears to be fortunate. But a comparison between the public company and the big individual trader is in many respects a comparison between unlikes, and must not be pressed too far. For the company, as such, is a collective body, which cannot enjoy the privilege of personal wealth, and its shareholders may be rich or poor.

400. *The quality of company savings.*—It remains to be considered whether the tax on this kind of saving is inherently more harmful to the community than tax on other kinds.

Saving left to the individual takes a certain amount of time; there is apt to be some delay and economic friction before the money reaches its destination. Moreover there is no certainty that it will flow in the direction most desirable from an economic

and industrial point of view; it may be wasted on unsound speculation, or, on the other hand, it may concentrate too much on gilt-edged stocks or on foreign or Colonial securities. Industry may not get its proper share, or may have to divert a great deal of its energy in order to do so.

On the other hand, when a company saves by retaining part of its profit, the operation is smooth and simple. In the case of a progressive business the flow of capital is just in the place where it is required; it is at the growing-point of industry, enabling new needs and opportunities to be met without delay as and when they arise. This is true of the new enterprising business, which may as yet be making only small profits, as well as of the established company whose ability to save large sums for development year by year has given proof of efficiency and power of continued expansion. There are cases of course where reserves are accumulated out of caution rather than enterprise, and are invested, e.g., in the preference shares of outside concerns, but generally speaking it is true that the Income Tax, when it falls upon company reserves, entrenches upon a form of saving which is of special value to the community.

401. *Conclusion as to effect on reserves.*—Income taxation, we have seen, absorbs a large amount of the savings of public companies. As against this, we believe that the tax has had a considerable effect in inducing companies to withhold larger gross amounts from distribution. There are also other factors which modify the directly damaging effect of the tax. The fact that part of the tax, so far at least as it is applied in payment of debt interest to the public, may find its way back into industry is a partial compensation, although it does not perhaps go far. What is more important is that public companies are themselves large holders of debt. On the basis of Mr. Layton's analysis of debt holdings (*para.* 263) it might be conjectured that companies, including joint stock banks, hold something between £1,500 millions and £2,000 millions, only a small fraction of this amount being attributable to private companies. Thus if we take into our view the total income resources of public companies, and the effect on those resources not only of the tax abstracted therefrom but also of the disbursement of tax revenue in payment of debt interest, we see that the corpus out of which reserves can be built up is not so seriously reduced by the Income Tax as at first sight appears. We have to take a view as comprehensive as this, if we are not to over-estimate the true effects of the tax.

It is necessary, however, to look still further in order to judge the whole position. The resources of public companies, as well as of individuals, are directly affected not only by the Income Tax, but also by the unproductive nature of the debt investment —a separate factor which it is constantly necessary to distinguish (*cf. paras.* 364 and 377). *In combination*, the two factors (i)

Income Tax, and (ii) the unproductive debt investment, are a considerable hindrance to the accumulation of company savings and an obstacle to development. How serious the matter is largely depends on the question whether industry is short of capital. There does not seem to be clear evidence of any general or marked shortage for immediate needs. It cannot then be demonstrated that any grave damage has been done to company savings in general, even when the standard rate of Income Tax was higher than it is now.

402. We have seen that industry as a whole appears to be building up reserves, which, after Income Tax has been deducted, still compare favourably with those before the War. This is not true, however, of the export trades, especially of mining, iron and steel, etc., whose undistributed profits are well below their pre-war standard (*cf. para.* 51). It may be urged that they are particularly handicapped in competition with exporters of other countries where income taxation is relatively low. This question has to be considered in the perspective of the general difficulties of those engaged in export. It can safely be assumed that with a lower Income Tax they would usually allocate a great part of the extra margin of net profit to reserve. While, however, this would do something to strengthen the financial position of companies and tide them over a slack time, it would be of very little avail towards promoting business expansion. In general the export trades are suffering not from a lack of capital goods, productive plant, etc., but from the reduced purchasing power or demand of many foreign countries, and from the relatively high costs of production here. Income Tax, as we have seen, does not enter into costs of production. It is true that, if the tax were lower, companies might sometimes be willing to execute orders on a rather smaller margin of gross profit, and so to some extent increase their business, but we agree with Sir Felix Schuster that " at the present moment other questions of far greater magnitude enter into the problem of competition in foreign markets, and the Income Tax can only be a comparatively minor consideration. (*Ev.* p. 10; *E. in C.;* 10).

(iii) *Enterprise of Companies.*

403. The enterprise of companies, when once established, depends on a small number of managing heads. In the interests of the business, whether the primary purpose be dividend or reserve, the aim of directors will be to make as large a profit as possible. They will of course balance risks against chances of profit, but the Income Tax, although it may exist in the background as a vaguely depressing element, will not normally enter into their calculations, except so far as it may increase their desire to provide for a large payment to reserve. They are not concerned with the Income Tax on dividends, which is borne by the shareholders; as regards the undistributed profit, however

large it may be, the last pound of it will only bear tax at the same standard rate as the first, Super-tax being out of the question.

Sir John Mann suggested that there is a psychological effect adverse to the enterprise of companies, since " in all really well managed businesses the men in control have an interest in the results " (Q. 3473). We recognise the bearing of this argument, but are not convinced that it has much force. So far as the system of remuneration according to results acts as a special stimulus, the Income Tax may possibly tend to weaken its effect. But the benefit of the whole concern is normally the overriding consideration of those in control. Their own interest is derivative, and the question of their personal Income Tax liability can, we think, only affect them remotely in their consideration of broad policy and total trading results.

We attach more importance to an indirect effect which is only partly psychological. There must be some reaction on the enterprise of companies, so far as the physical basis for expansion, viz., reserve strength, is injured by the tax. Risks will as a rule be more readily taken, and more justifiable, when a company is in a relatively solid position.

404. A further question is how the Income Tax affects the formation of new companies and the consequent provision of employment. Whether the point of view taken be that of those forming the company or of the investing public, a leading consideration is that, in whatever direction capital may be employed, the income from it will be liable to taxation. The enterprise of company promoters and underwriters will, however, be affected by the amount of capital seeking investment and by the attitude of the investor. So far as the flow of capital is diminished by the Income Tax and inclined towards the gilt-edged class (*para.* 265), the prospect of placing new industrial issues successfully becomes more uncertain. This may have a tendency directly to check the formation of new concerns, especially of the speculative type, although the figures of company registrations in recent years (*cf. para.* 568) have been quite high : it may also influence underwriters to require larger remuneration to cover their risks, and so, by increasing the expenses of company formation, may tend indirectly to discourage new enterprise. Similar considerations apply to some extent to new developments of old concerns. We are disposed to attribute to the Income Tax a minor, but still appreciable, influence. In this matter, however, it is not possible to disentangle taxation from wider and more important causes.

(iv) *Transfer of Residence Abroad and allied effects.*

405. A company " resident " in the United Kingdom is liable to British Income Tax on the whole of its profits wherever it may carry on its trading operations. In broad terms, a company

is said to reside in the country from which it is effectively controlled.

406. *Transfer of residence abroad.*—It is known that the high rates of Income Tax have been the cause or occasion of some companies removing their head office and control from this country. The Board of Inland Revenue provided us with a short statistical paper, which we print as Appendix XVII, with certain details showing the total number of transfers which they have noted since 1916. We understand that of the 128 cases comprised, 73 relate to public companies, 42 to private companies, and 13 to individual traders and partnerships : of the £4,653,000 aggregate Income Tax assessments for the last year for which the concerns were liable, £4,082,000 represent assessments on public companies. According to the assessment figures as a whole, the most important transfers would seem to have taken place in 1920-21 and 1921-22, the figures for the two following years, and, we believe, subsequently (*Hopkins*, Q. 9114) having been relatively small. It is important to note that of the 128 concerns only 26 had their main activities or branches in the United Kingdom, and that only 6 of these 26 carried on manufacture in the United Kingdom.

The Board of Inland Revenue state that in most of the cases pressure of taxation was alleged as the cause of the transfer of control abroad. They comment that this reason is particularly relevant in the four known cases where the great bulk of the shares (not merely, as in many cases, the predominant part) belonged to persons abroad, but they add that in many cases other factors are indicated. Generally, indeed, it appears that the British Income Tax can only have been a contributing element. In some cases it will no doubt have been of leading importance, while in others it will only have been decisive in the sense that it may just have turned the scale when added to other more weighty considerations. The forces tending to removal abroad will usually be less strong where the shares of the company are mostly held by persons in this country, for such persons would be equally liable to tax on their dividends wherever the control might be. In such cases the effect on reserves is likely to be the main anxiety caused by the British tax. This anxiety may be heightened by liability to foreign income tax in the countries abroad where trade is carried on. Income taxation has become widespread in recent years and, subject to certain exceptions in the case of shipping, no provision yet exists for relief from double taxation such as those in force between this country and the Dominions. The weight of the foreign and British taxes together is sometimes extremely heavy.

In the circumstances, the figures given to us by the Board are somewhat reassuring. The loss of business to this country due to concerns transferring their residence abroad, is most regrettable, but it does not appear to have taken place on a very large scale. The loss was apparently most considerable in 1920-21

and 1921-22, a fact which may naturally be connected with the continuance of 6s. in the £ as the leading rate of Income Tax from 1918-19 to 1921-22 inclusive.

407. *Prevention of Residence in the United Kingdom.*—It was suggested by Lord Forres that, while the authorities know what is lost by the removal of companies abroad, they do not fully appreciate the complementary aspect, i.e., the number and importance of undertakings which are prevented from forming British companies. Speaking with special reference to enterprises the ownership of which is in few hands—sometimes British, sometimes alien—he informed us that, in his own experience, he knew several large concerns operating abroad which had been deterred from establishing themselves here; this might even happen on account of the British tax alone, when there was no question of double taxation. (*E. in C.*: 7 (3) and 9; and Q. 7816.) There cannot of course be any statistical evidence on this matter, except so far as any inference can be drawn from the figures relating to removal of business concerns abroad. Sir Richard Hopkins thought that those figures showed there had been a tendency to exaggerate the movement abroad: similarly there might be a little inclination to exaggerate the loss of new business (Q. 9118). It may be noted that the tax will normally be less of a deterrent to the large corporate concern with many shareholders than to the business in a few hands; in the former case only the standard rate of Income Tax would as a rule have to be considered, while in the latter the question of liability to Super-tax would be involved. A special point brought to our notice by Sir Richard Hopkins is that "so far as foreign capital is desired at the present time to be introduced into the British Dominions, working through London is not so great a disability as would at first sight appear. Supposing, for example, a foreign syndicate wished to invest capital in India, it would there be subjected to 3s. 1½d. of Indian Income Tax and Super-tax. If it works here, its total burden would only be increased by 10½d., because of the double Income Tax relief which exists between this country and the Dominions." (Q. 9118.)

Lord Forres further examined the effect on our commerce of the British Income Tax, in conjunction with foreign income taxation, by explaining the difficulty of establishing British enterprises abroad, particularly in certain countries, and the difficulty of keeping foreign branches of British enterprises under the control of the parent concern. He pointed out that, when such enterprises or branches are controlled from the United Kingdom, they are usually linked up with all kinds of home trade—manufacture, banking, insurance, etc. He attributed the loss of such business not to the British Income Tax as such—he considered that the profits of international trade ought to pay an Income Tax (*E. in C.*: 8)—but to double taxation. We understand Lord Forres to have been primarily concerned throughout with the private business or the business concentrated in a few hands.

His arguments would apply with less force to the large public company, for in many cases the gross rate of return obtainable in a foreign country may be so high as to make business remunerative even after payment of two income taxes. The position may be quite different for proprietors of a private business who are faced with British Super-tax and, in some cases, with a corresponding foreign tax.

408. *Conclusions.*—The root of the trouble appears to lie to a great extent in double taxation. The examination of the double tax problem has been ruled to be outside our province, but we are bound to take cognisance of its existence, for the effect of the British Income Tax on our trade with other countries can hardly be appreciated without reference to similar foreign taxes. Double taxation is, we think, a very real hindrance to the smooth working of our international trade; if there were a reasonable system of relief, it does not appear that the British tax at the present rate need be especially harmful.

In dealing with foreign concerns, we have directed attention to companies operating abroad which might be inclined, other things being equal, to establish their head offices in the United Kingdom, chiefly for the sake of the financial facilities offered by the British market. The position is rather different in the case of a foreign concern considering whether to set up a business with its actual operations in the United Kingdom. We agree with Sir F. Schuster (Q. 107) and Mr. R. H. Brand (*E. in C.:* 8) that the British Income Tax need not prevent such action, if there is a good gross return in prospect.

III.—INCOME TAX AND THE PRIVATE BUSINESS.

(i) *The Classes of Private Business and their Distinction from the Public Company.*

409. The term "private business" covers the individual trading on his own account, the partnership and the private joint stock company. The last named is virtually a partnership with limited liability, the great bulk of the profits going—whether in the form of salary or of dividend—to the few persons who, in effect, own and control the business.

410. To some extent the position as regards Income Tax of individuals carrying on a business alone or in partnership differs from that of persons controlling a private company. If an individual carries on a business single-handed, his personal income for Income Tax purposes includes the whole of the business profits, whether kept in the business or not; the whole of the profits therefore bear tax at a rate which depends on the amount of the individual's total income, including his income from any other source. Similarly, the whole of the profits of a partnership, whether kept in the business or drawn out, are taxed in

the hands of the partners, more or less heavily according to their several incomes. On the other hand, in the case of a private company, even if it be a family concern or a " one-man company," the profits retained in the business are normally not regarded as personal income at all. Under recent legislation, however (Section 21 of the Finance Act, 1922), these profits may in some cases be so regarded, if it is held by the Special Commissioners of Income Tax that a less than reasonable amount has been distributed. The provision applies to private companies registered since the 5th April, 1914, which are under the control of not more than five persons; its avowed object is that of " preventing the avoidance of the payment of Super-tax through the withholding from distribution of income of a company which would otherwise be distributed." Apart from this exception, the profits kept in a private company bear Income Tax at the standard rate, just in the same way as the reserves of a public company, and are similarly not brought within the charge to Super-tax.

411. The partnership and the private company may, however, properly be treated together, and marked off from the public concern. The essential difference is quite simple. The individuals controlling a private business—firm or company—are practically the sole persons financially interested in the result of its trading; as a corollary, they bear the brunt of taxation upon the profits, not having outside shareholders to whom they can pass it on. Again, since they cannot offer shares to the public, they are thrown back much more upon their own reserves. The only way in which they can build up their capital, unless they are in a position to increase their individual interests in the business from other resources, is by saving from their profits.

Thus, the private business is much more self-contained, and therefore more personal, than the public; equally, its conduct is more liable to be determined by individual motive.

(ii) *Comparison of the Private Business with the Profession, &c.*

412. The man engaged in the conduct of private business has not only personal and family motives for saving and enterprise similar to those of other individuals, e.g., professional men and employees. He has strong additional incentives or deterrents due to the nature of his work; they arise from the continuing need for capital, and the continuing possibility of loss.

413. A good deal of capital may have been sunk in the education and training of the professional man, but, generally speaking, once his career has started, he relies mainly on his immaterial " brain capital." The doctor or the lawyer, in order to succeed, may have to work hard against competition, but, so far as success in his own profession is concerned, he will not

necessarily have to save hard; even when he has won a reputation and his position is more secure, while he may still be spurred to effort by pride or interest in his work, he may not feel any corresponding stimulus to save. Again, he may work hard simply because he wants an outlet for his energy apart from any other motive. There is, indeed, no intrinsic reason why the virtue of thrift, which is allied to caution, should go hand in hand with energy or enterprise; and the professions, since they are so little dependent on material capital, do not exert any very compelling influence to bring them together.

414. In the case of the man personally engaged in business thrift and enterprise are much more interdependent. In the struggling business the necessity for fresh capital may be no less urgent than the necessity for hard work and initiative; the trader may have to save in order that the business in which he depends for a livelihood may survive. Again, in the prospering, go-ahead business the will and the ability to expand require to be backed by a continual flow of savings, if they are to be effective.

415. The possibility of loss, to which we have alluded as one of the springs of action for the business man, varies, of course, indefinitely from industry to industry, from one time to another in the same industry, and so on. Its psychological effect on saving and enterprise may be in either direction. Sometimes it will spell the need for caution and economy, particularly in the small business which has not much reserve strength. Sometimes it will be merely one side of the coin, the other side of which is the possibility of large gain; the balance of chance against risk may then call out the spirit of adventure.

Since saving and enterprise are so closely linked in the private business, we propose to consider them together, looking first at the physical effect of the Income Tax, and then at the psychological effect.

(iii) *The Physical Effect of the Income Tax on Saving and Enterprise.*

416. We have already discussed the weight of the Income Tax on individual incomes. In summarising the effect of the Income Tax on the savings of the general public (as distinct from persons engaged in business of their own), we concluded that it did not appear to be appreciable in the range of incomes up to £500; in the range from £500 to £2,000 it appeared to be quite considerable (subject to a contrary tendency on the psychological side); above £2,000 it became more serious, especially when in conjunction with effects which proceed from the absence of any real return on investments in the debt (*para.* 377).

In dealing with the effect of the Income Tax on public companies, we have stated that when the tax falls (at the standard rate, in all cases) on company reserves, it entrenches upon a

form of saving which is of special value to the community (*para.* 400).

417. As regards the small trade corresponding to the group of incomes up to £500, the burden is not heavy. If the trade is increasing its profits from year to year, it benefits by the three years'* average basis of assessment.

418. We have seen that in the range of incomes up to £2,000, family and old age provision by life insurance, &c., makes a strong claim on the individual's savings. In the case of the trader, particularly if married, this claim will come into conflict with that of his business, and of necessity will often take precedence. The Income Tax reduces the fund available for saving in the two directions, and the savings for the business may particularly suffer.

The extent of the damage depends very much on the efficiency of the individual. Where the business has little push and little power for growth, it will not be great. The effect of the tax levied on the inefficient business man is, from the point of view of the community, less directly harmful than that of the tax on members of the public who invest with reasonable sagacity. On the other hand, small businesses capable of expansion suffer a real hindrance, even after allowance has been made for benefits from tax revenue, so far as applied in service of the debt.

419. In the case of the larger businesses owned by Super-tax payers (other than private companies, whose reserves are normally not liable to Super-tax), the damage is in some degree accentuated, although due allowance must again be made for benefits from the service of the debt. The effective rate of tax becomes very high; in 1925-26 it approached towards 10*s.* in the pound in the largest incomes. It exceeded the standard rate of 4*s.*, payable on public company reserves, at an income in the neighbourhood of £4,000. Thus it would seem very difficult to increase the disparity by a special relief in favour of the public company, leaving the large private business on the existing tax basis; a case could be made for corresponding relief to the private concern on the ground not only of equity but also of the value of its saving to the community. Even in existing circumstances, Mr. E. B. Tredwen, representing the London Chamber of Commerce (Merchants' Section), advocated that private firms should be placed on identically the same footing as companies (*E. in C;* 14 and Q. 7369).

420. Mr. McKenna, in speaking of taxation for the redemption of debt, urged that "the danger of excessive taxation" lies in the fact that "most is taken from those whose capital is being used most efficiently." He pointed out that "the rule with successful enterprises is to build up reserves. . . . Heavy

* This basis is, however, to be superseded from 1927-28 onwards by the basis of the preceding year's profits.

taxation retards the growth of these reserves, and it is no compensation to the highly efficient firm or to the country that the total of the capital in other hands less capable of using it well is not diminished." (*Ev.*, p. 132; *E. in C.*; *Ans.* 1 (*b*).) In relation to the private business of enterprising character but without a wide public appeal, the argument merits particular attention : this class of business is qualitatively important, if not numerically so. Income Tax revenue distributed to the public in debt interest and in repayment of debt may largely be available to industry, but it will tend to flow rather to the big public companies. It will be less easily attracted back, as loan capital, by the little-known private business, whose power to build up reserves has been impeded by the tax. The business may in consequence be compelled to have resort to its bankers.

421. Here, however, it is important to remember that the taxpayer who has a large private business may also have resources outside his business rendering him less dependent on the public and on his banker. In this connection, memoranda supplied by the Board of Inland Revenue are of exceptional interest (*Appendices* XIX and XX). They show that normally the partners in a large private firm, or the proprietors of a large private company, have a high proportion of their means invested outside their own concern. It is thus within their power to strengthen the basis of the business by sinking in it, or lending to it, further capital. If there are great prospects of developing the business, they will naturally do this, for the free personal use of capital in such a case is likely to be the most profitable use open to them. They are not as a rule forced to fall back upon the banks, and the figures provided by the Board relating to the bank credits and debits of private concerns are evidence against the present taxes having in fact driven them to a state of dependence for permanent capital. There will, of course, be occasional exceptions when a particular business will have been injured.

422. We think, then, that Mr. McKenna has indicated a potential danger of high taxation rather than one which has been widely realised. The present Income Tax and Super-tax would have to be very substantially higher, before the typical large and progressive private business would be in a state of actual distress owing to the depletion of its resources.

(iv) *The Psychological Effect of the Income Tax on Saving and Enterprise.*

423. On the Committee's question how far taxation acts as a deterrent to saving and enterprise, Mr. Hirst replied, " I should say that taxes do not so much deter as prevent savings. Graduated taxation encourages the enterprise of a poor business man; but as he becomes richer it acts as a deterrent to further extension." (*E. in C.*, 16.)

The Income Tax, as at present graduated, does, we think, confer a differential advantage on the very small trader which is a slight offset to the economic advantages of a large personal aggregation of capital. But we doubt whether it is effective after the point where the tax begins to be really felt. Generally speaking, we should regard the psychological effect as neutral for traders with profit up to £500 per annum. If, however, the graduated Income Tax is compared with a flat rate tax, it may certainly be said to be favourable to the small man, and in particular to the man commencing business. The tax is too light to deter him, or to figure prominently in his business anxieties.

424. In the case of the rather more prosperous trader—up to, say, the £2,000 limit—the question is very largely a matter of individual psychology, as was emphasized by the Association of British Chambers of Commerce (*Ev.*, p. 291; *E. in C.* 54 *et seq.*).

Through lack of ability, energy or opportunity it may not be open to a trader to obtain a larger gross profit and so to neutralise the burden of the tax: with the same gross profit he will only have the alternatives of reduced saving or reduced consumption, and his choice will depend on all the varying elements of character and circumstance.

The trader of reasonably good ability and enterprise will, we think, in the normal case be impelled by an Income Tax at a high or fairly high rate to increase his efforts: we have stressed his need of all the savings he can make (*para.* 418), and we think that the tax will as a rule exert quite a powerful driving force. It is true that the sort of impulsion which proceeds from necessity has not the same tonic value as encouragement due, for instance, to good prospects: it may be coupled with depression and not with enthusiasm, and it is possible that, if the extra effort does not show early signs of success, it may be partially relaxed. Nevertheless, in this range of incomes and for some distance beyond the £2,000 limit, we think it probable that the present income taxation definitely increases the business man's output of effort.

425. It is in the higher ranges of income that the question assumes its main importance. When the physical effect of the tax on the larger trade incomes was considered, the rate of tax which required attention was the effective rate on the income as a whole. In dealing with the psychological effect, we have also to pay regard to the rate applying to the last increment of income. To take two examples: under the 1925-26 scale the effective rate on the income of a trader (unmarried) with £5,000 is 4*s.* 6½*d.*, and, if he had £6,000, would be 4*s.* 11½*d.*; the rate on each pound of income between £5,000 and £6,000 is 7*s.* Again, the effective rate on an income of £30,000 would be 8*s.* 1½*d.*, and on £40,000, 8*s.* 7*d.*; the rate on each intervening pound would be 10*s.*, i.e., the sum of the standard rate of Income Tax and the highest rate of Super-tax.

426. The purely personal utility attaching to an increment of income diminishes as the income grows : at the same time the percentage taken in tax increases, at points determined by the Super-tax scale. It follows that, if the business man did not identify himself with his business but viewed matters from a merely personal angle, he would tend—even apart from taxation —to make less and less effort to increase his profits : this tendency would be reinforced by the increasing toll of tax.

In fact, owing to a great variety of motives, the wealthy business man does not view the making of effort and the taking of risk from a merely personal standpoint. No general rule can be laid down that he tends to slacken as his business grows. Similarly, it is not safe to assume that a tax of, say, 10*s.* at the margin of his income will have as great a deterrent effect as its face value suggests.

427. It was agreed by many representatives of business that the Income Tax had a serious effect in repressing large enterprise. Great emphasis was laid on the decreased remuneration for risk. Thus the Federation of British Industries pointed out that " risk of loss is inseparable from the early stages of new enterprises and of new developments of old enterprises, and in actual practice this risk is almost invariably borne by a single individual, or at most by a small group of individuals." The Federation spoke of " the present lack " of the spirit of adventure and attributed it in part to existing taxation, although allotting " a large share of the responsibility " to more general causes (*E. in C.*, 56-58). Lord Hunsdon, again, stated that " the prosperity of this country has been made by adventuring money in new enterprise, and the present system of graduated taxation not only checks the accumulation of capital, but has to a great extent stopped new enterprise and will, I think, stop it more completely as time goes on, for in any risk that is taken the Government now take a very large share of the profits and leave the whole loss to the adventurer " (*E. in C.*, 5).

428. Opinions in a contrary sense were expressed by other witnesses. " I cannot myself conceive," said Lord Bradbury, " that merely* taking away half of a man's profits makes him any the less keen on earning profits ; indeed to some extent I think it might make him more keen, because, having only half left, he is naturally much more anxious to make money. A man may say : ' Well, as I have to part with one-third of my profit, it is not really worth making profits at all,' but I doubt if in practice he acts on the declaration." (Q. 9192.) Again, the view taken by most of the economists was that the present scale has no very serious effect on work and enterprise. Mr. Layton cited the economic theory that " on the whole a tax on income ought not to affect economic action for the reason . . . that prices and the amount of production are determined by the cost

* Lord Bradbury regarded the Income Tax as damaging to the entrepreneur, in so far as there were flaws in it making it " not a real tax on actual profits."

of output at the margin where no profit is made, that the Income Tax is a tax on the surplus, and that production will continue under competition to the point where profit stops." "But," he added, "this theory has to be qualified in important respects. It is not quite certain that people act so exactly according to the laws of economic theory, or that competition works quite in that way. It is suggested, and I think there is something in it, that people are actuated by an idea of a conventional rate of profit—what they think is the proper rate of profit. One is always being told that people will not do this, that, or the other, because taxation is now such that the net profit is much lower than it used to be, and it is not worth it; in other words, there is some relation between a certain rate of profit and the effort that people think is worth making, or the risk that they think it is worth undertaking, and so forth." (Q. 2543.) Mr. Layton's conclusion on this point was that "the heavy direct taxation of profits may have had some small effect in checking business, through reducing the net profit of given enterprises below a conventional standard" (*E. in C.* 19). He thought it might be true that the taking of big risks was affected, although there were opposite motives in operation. (Q. 2568-9.)

429. The question as regards saving is in one respect less controversial than that as regards enterprise. Allowance must be made for temperamental reactions to high taxation, which may perhaps be more often in the direction of extravagance than of extra economy. But it remains true that the saving of the wealthy business man is to a considerable extent automatic, and therefore not subject to psychological influences. In spite of the heavy taxation there is still a large flow of capital demanding employment: correspondingly there is still a large, though reduced, automatic stimulus to enterprise. Of course the money may be used in different ways. Mr. McKenna was of opinion that, paradoxically, the business man will sometimes put his money into other people's risky investments rather than take a risk in his own business, with the attendant trouble and anxiety (Q. 2016-7). This appears to be possible, for the risk of a blind venture or gamble sometimes holds out greater attractions than a dangerous game of skill; and, of course, the advantage of spreading risks has always to be considered.

430. The difficulty in a matter of this kind, where there is room for a wide variety of personal impressions, is to get anything like conclusive evidence. A view expressed by Professor Cannan that personally he did not believe "that the existing scale has any important effect in causing people to slack, or to retire from work early, or to consume more" furnished a text on which we asked the Board of Inland Revenue whether they could furnish any statistics, showing the proportion of the earned to the unearned income of Super-tax payers with taxation at the pre-war and the post-war level; we also asked whether it

would be possible to classify the particulars according to age-groups.

431. In response to this request the Board furnished tables for the years 1913-14 and 1922-23, based in each case on a large sample of incomes exceeding £10,000.* The tables are given in Appendix XV. The figures do not in any way indicate that the increase of taxation has had a material influence either on the proportions of earned income, or on the relative number of individuals part of whose income is earned.

With regard to classification by age, the Board were able to give figures for 1922-23, but not for a pre-war year. The 1922-23 figures are in themselves interesting. On the sample taken they show that, of the total number of taxpayers with incomes exceeding £10,000 and partly earned, almost 23 per cent. were 66 years of age and over.

432. In the absence of similar data for a pre-war year, Mr. Coates (*E. in C.*, 28) suggested an illuminating comparison with the 1921 Census figures of age distribution in the employing and professional classes as a whole. These figures cover incomes of every size, and the number of small incomes subject to a light rate of tax must therefore preponderate in the totals. The 1921 Census shows that of 587,300 males aged 45 or over in the classes mentioned, 87,900 or 15 per cent. are aged 65 or over. As compared with this, the table relating to incomes above £10,000 shows that of 5,280 aged 46 or over, 1,407 or almost 27 per cent. were aged 66 or over.

Mr. Coates pointed out that, in the Super-tax table, the tendency for age and wealth to be associated no doubt introduces some bias towards the highest age-group. But, when every allowance has been made for this and other considerations, we agree that the comparison lends no support to the view that the weight of post-war taxation tends to deter the wealthy man from continuing in business after reaching an age at which he might well retire.

433. *A priori*, it might be expected that the post-war rates of Income Tax and Super-tax would act as a powerful deterrent to enterprise on a large scale. But, apart from statistical evidence, there would be reason to suspect that this anticipation might be wrong. The post-war rates of tax appear formidable, but the fact that they can be and are borne is in itself sufficient proof that the effect of income taxation has been exaggerated in the past; history suggests that there is a natural tendency to over-estimate it. For example, the following extract from a speech made in Report stage of Ways and Means on the 14th May, 1914, is typical of a point of view which was widely taken in the years just before the War:—" We are at the present moment in a time of profound peace, to all outward appearances, and we all hope that it will continue, but here we are with an Income Tax at the nominal rate of 1*s.* 4*d.* in the £, and in

some cases more. These enormous direct taxes are far higher, I believe, than they have ever been in this country before—taking the death duties and the Income Tax together" (H. of C. Deb., Vol. LXII, col. 1340).

Further, as we have intimated (*para.* 424), the Income Tax may depress the outlook of the trader, even if it impels him to increased effort. Obviously, so far as it has had this double effect, it is likely in a period of bad trade to bear the blame for results which are in fact due to much more general causes.

In any case it would be difficult, in face of the statistical evidence referred to above, to maintain the view that as a whole the enterprise of the wealthy business man is very seriously damaged.

434. The evidence, however, must not be pressed too far. We believe that some real injury is done, and we think it likely that there is a rather deterrent effect on the export trader, "since," as Mr. McKenna said, "the net profit earned may be insufficient to compensate for the trouble and risk of foreign business" (*Ev., p.* 133; *E. in C., Ans.* 10). It is possible, too, that the taking of very large risks of any kind may be considerably affected. It has to be remembered, however, that the very speculative class of enterprise, e.g., gold mining, is normally undertaken by the public company and not by the private concern. The private individual who starts a risky venture frequently disposes of it after the initial stage, leaving the risks of operation to be borne by the general shareholding public.

The risks normally taken by the wealthy individual should, therefore, not be over-stated. On the other hand, the part played by him in the initiation of risky enterprise must have due recognition. We think that witnesses who drew attention to this particular aspect were justified; it is probable that here the high rates of tax have inflicted some degree of definite harm. The area over which the harm can have been done would appear to be restricted, but, on the other hand, no estimate can be formed of the loss which a community may suffer from the missing of even a few big speculative opportunities. It may, or may not, be important; it must remain an unknown factor.

(v) *Transfer of Residence Abroad and allied effects.*

435. Before summing up certain of the main effects of the Income Tax, we may briefly glance at the loss of private business due to the transfer of residence, &c. In general, the same considerations apply as in the case of public companies, and we may refer to our discussion in paragraphs 405-8. We have seen that, of 128 cases of transfer abroad noted by the Board of Inland Revenue since 1916, 42 relate to private companies and 13 to individual traders and partnerships; of the £4,653,000 aggregate Income Tax assessments on the 128 concerns for the last year for which they were liable, £571,000 represent assessments on these 55 private concerns.

436. The assessment figures in themselves are not very large, but the enterprise of merchants doing pioneer work abroad remains, as it has always been, of special importance to the trade of this country. The merchanting or other business in private ownership is more handicapped by taxation than the public company, so far as there is liability to Super-tax (sometimes including foreign surtaxes) as well as to Income Tax (*cf. para.* 407). Special attention was drawn to the burden of Super-tax on the merchant by Mr. Tredwen, representing the London Chamber of Commerce (*E. in C.*, 10-14). Lord Forres, who emphasised the loss of new business (*cf. para.* 407), discussed the whole subject in the perspective of double taxation, and it is in this setting that the present situation takes on its more important aspect. We were considerably impressed by his evidence; in relation to the private business it appears to us to carry especial weight.

IV.—SUMMARY OF MAIN CONCLUSIONS.

437. Having analysed the effect of the Income Tax on the individual, the public joint stock company and the private business in turn, we may now summarise our main conclusions. We will do so under four heads :—

(i) The price level.

(ii) The standing of living; purchasing power.

(iii) Saving.

(iv) Enterprise.

438. *The price level.*—We have seen that, with unimportant exceptions, the Income Tax is not passed directly into the price of goods and services. Whether prices are indirectly affected is another question, depending on the total effect of the tax on saving and enterprise. Saving and enterprise are undoubtedly diminished to some extent as a result of the physical transfer, under progressive taxation, from the larger to the smaller income; they are further diminished on account of the psychological reactions set up by the inroad which the tax makes into the pure interest yield and into the reward for work and risk. So far as the Income Tax, operating in these ways, has any tendency to reduce the volume of production, it must also have a tendency to increase prices. Mr. Coates has shown in Part VII of his paper on the Incidence of the Income Tax (*Appendix* XI) the difficulty of tracing any influence of the rate of Income Tax on prices through the medium of the rate of interest. We are satisfied that, when the application of the tax revenue is taken into account, the higher level of post-war income taxation has not had anything approaching a commensurate effect on the level of prices. It appears to us that over the whole field its influence on prices has been of little relative importance, and that it has not, in this

aspect, tended to reduce materially the power of the public to purchase consumable goods. A more important factor is the deficiency of real income which lies behind taxation for the debt; if its effect on prices could be measured, it might be found to be very appreciable.

439. *Standard of living: purchasing power.*—With regard to the individual's standard of living (*paras.* 351-364), the general effect on the Income Tax paying class has been to reduce consumption to some extent, although to a less extent since the rates of tax have been lowered. We see no reason to think that, on balance, luxury expenditure has been very materially checked —in some cases the reaction has undoubtedly been towards extravagance. Economies due to the tax must, we think, have been most considerable in the class of persons with moderate and, for the greater part, earned incomes, where the pressure of the tax is particularly felt. The general character of the expenses here retrenched will not have been distinctively luxurious. In many cases real sacrifices will have been involved, especially where the taxpayer has heavy family, etc., responsibilities. The late Lord Leverhulme suggested that the public's purchasing power was directly affected by " the burden of excessive Income Tax," smaller output and higher prices being indirect consequences. (*Ev., Appendix* III; Q. 10.) This opinion regarding the effect on the general purchasing power of the community appears to be untenable, in view of the limited numbers—roughly about 2½ millions—who pay any Income Tax, and the lightness of the burden on small liable incomes. Moreover, the use of the Income Tax revenue cannot be ignored. In particular, so far as it is applied in payment of pensions, unemployment relief, etc., it supports the purchasing power of the worker and increases the total effective demand for necessaries. Reduced expenditure in the middle class of incomes, together with the proportionate application of Income Tax revenue to social expenditure, may go some slight way towards explaining how the workers' average standard of living has been maintained—as appears to be the case—in spite of a decrease in total production, and in spite of any adverse effect of increased indirect taxation.

As we have pointed out, the loss of real wealth due to war expenditure has to be distinguished as a cause limiting the power to spend and save in a more fundamental way than the Income Tax or any part of the tax system. Owing to the steep graduation of the taxes as a whole, the loss falls with progressive severity on the wealthier members of the community.

440. *Saving.*—National savings and national production are alike dependent on two great factors, saving or economy on the one side, work and enterprise on the other. A substantial part of the national saving is done by industry on its own account. Public joint stock companies, while they look to the investing public for a continuous stream of capital, supply a large part of

their own needs by placing sums to reserve out of profits (*paras.* 392-402). In general, this is an especially valuable form of saving. To judge from figures supplied by the Board of Inland Revenue relating to 1912, 1922 and 1923, it appears that in spite of the Income Tax, aggregate reserves have been maintained at about the pre-war level, after allowance for the different purchasing power of money. The result has only been achieved by companies in the mass having withheld from distribution a larger proportion of their net profits after payment of Income Tax : this increased collective economy may partly be traced to the Income Tax. At the same time it seems likely that the more uncertain conditions of trade since the War have made industry especially anxious to strengthen its reserve funds, and that, if the Income Tax had been lower, a good part of the extra margin of net trading profit would have been used for this purpose rather than for dividend. It is likely that export trades have been particularly affected in this way.

441. The effect of the Income Tax on the individual investor is on balance to encourage, and in some cases to enforce, economies, particularly among persons of moderate income. Further, in so far as the tax is merely redistributed in payment of debt interest and repayment of debt holdings, it appears to exert a favourable influence on the amount of savings. The burdensome part of the tax remains, however, and retrenchment has not provided a sufficient fund to meet it. The savings of the Income Tax paying class have therefore suffered ; the effect has been most severe in the larger incomes liable to high effective rates of tax, even when the large benefit they receive on account of debt interest is borne in mind. The situation has, however, been much relieved by the reduction of the rates of tax since 1921-22, when the standard rate was 6*s.*

442. The steep graduation involves a redistribution of saving power in favour of the moderate and lower incomes. Largely as a consequence of this, but also owing to other considerations, the Income Tax has some tendency to encourage the safer as against the more speculative type of investment. Savings through life assurance—aided no doubt by the tax relief granted in favour of premiums—appear to have been maintained better than the general rate of saving, while a larger proportion of industrial investment appears to have flowed into debentures and preference shares. Probably, however, lack of business initiative in a period of depression is indicated in greater degree than lack of enterprise in the public.

443. Individuals building up a private business, since they do not issue shares, have to rely on savings out of their own profits, except so far as they have resources invested elsewhere on which they can fall back. The Income Tax, as it has been graduated since the War, is not a heavy burden on the numerous very small traders, and it confers some differential advantage upon

them as compared with their larger and more heavily taxed competitors. It is often a real hindrance to the trader in the middle range of incomes, for he may find it difficult to save much surplus beyond what is required for life insurance and similar provision against personal risks. On the trader who is liable to Super-tax the burden falls heavily, though the benefit received on account of debt interest is an important set-off; while (subject to limitation) the reserves of a private company are only liable, like those of a public company, to the standard rate of Income Tax, the reserves of an individual trader or of a partnership are within the Super-tax charge. In the case of concerns operating abroad the position may be complicated by double taxation. In important individual cases, business expansion may be thwarted by the physical impact of the combined Income Tax and Super-tax upon savings: further, this may cause reactions towards extravagance as often as towards extra economy, although in the highest ranges of income such influences count for little, saving being largely automatic. On the other side, however, it appears from statistical evidence that in the majority of cases wealthy proprietors have a high proportion of their means invested outside their own business, and if their business offers the prospect of a good return on extra capital, they are unlikely to withhold the available supply. Thus the typical large private business would not appear to have been forced by the Income Tax and Super-tax into a position of serious difficulty.

444. We conclude with regard to the supply of capital from individual and corporate savings, that industry has suffered materially from the effect of high Income Tax and Super-tax. This remains true, when full allowance has been made for the proportionate application of revenue to the large payments on account of the National Debt which accrue directly or indirectly to the benefit of trade. On account, however, of the large benefits so derived, income taxation has not, on balance, been so prejudicial to saving as might *à priori* be expected from the high rates in force and the large yield.

It is common to include in the effect of the tax what we have attempted throughout to distinguish, viz., the effect of the loss to real wealth due to War expenditure, which is reflected in the internal debt. When, in addition to the Income Tax, this deficiency of real wealth is taken into account, the effect on national savings becomes much more considerable: the two together have no doubt tended to influence appreciably the general rate of interest, while it would be difficult to say this of the Income Tax alone.

445. *Enterprise.*—So far as concerns employments and professions, the Income Tax has no important influence on work and enterprise. It has some effect in inclining the affluent or established professional man to undertake rather less work than he otherwise would, so that a certain amount of extra opportunity

passes to those with smaller incomes or those at the beginning of their career.

446. Enterprise in the creation of new public companies, and in the development of existing companies, depends primarily on the general prospects of trade and on the supplies of capital available to industry. As an element contributing, if only slightly, to the depressed outlook of the trader, the Income Tax must in some degree be unfavourable. The public company, however, is not susceptible in the same way as an individual trader to the psychological influence of the Income Tax : those in control are not concerned with the tax in respect of dividends borne at various effective rates by the shareholders, while, as regards reserves, the rate of tax does not increase in accordance with the amount set aside, but is limited to the standard rate of Income Tax.

447. The reaction on the enterprise of public companies due to the restricted supply of capital, especially from the wealthier and more heavily taxed members of the community, is more important, although the situation may have been partly met by companies increasing their efforts to save out of profits. We think that in this indirect way the Income Tax has exercised an appreciable effect in damping down industrial activity, particularly of the more speculative kind : a cause which goes deeper, however, is the deficiency of national wealth due to war expenditure.

448. The enterprise of private concerns also is prejudiced by the diminution of their supply of capital, i.e., of the net amounts after payment of tax which the proprietors are able to put back into the business. In some individual cases, especially where there is heavy liability to Super-tax, the result will have been very injurious, but, on the other hand, it appears that in the great majority of cases the proprietors of large concerns have outside means from which they can supplement their business capital.

449. On the purely psychological side, the Income Tax has much more effect on the private business than on the public company. A high tax must normally make the taxpayer's outlook less sanguine, except when he is so used to it that he takes it for granted; nevertheless, the practical effect varies from case to case, and is not always harmful. In the middle range of incomes, and in incomes extending some way above the Super-tax limit, it is probable that, on balance, the tax impels the trader to increase his efforts. In the higher incomes the combined burden of Income Tax and Super-tax on the individual trader or the partner in a firm becomes formidable, successive increments of profit being liable to Super-tax at increasing rates. The reactions of the trader will differ, but more often than not the impulse may be to avoid extra commitments. As a matter not of impulse but of calculation, the tax may cut into the reward

for risk and trouble to such an extent that the difference between the net yield offered by personal enterprise and by the safer types of investment will be not sufficiently attractive; we have export business especially in mind. The enterprise of concerns operating abroad is often badly hampered by double taxation.

450. On the other hand. in competitive enterprise the general tendency is to carry on business up to the margin where profit ceases, under pain of losing ground to rival firms, and in any case the trader interested in the success of his business does not normally confine his outlook to the immediate net gain which he personally can reap. Statistics received by us from the Board of Inland Revenue do not support the view that the quantity of business activity has been seriously affected. We think it probable that the injury has mostly lain in discouraging the initiation of risky new enterprise, with a loss to the community which it is not possible to determine.

451. We conclude, with regard to enterprise, that the effects of high income taxation have been almost negligible in the field of employments and professions; over a great part of the industrial field, while appreciable, they have not been of serious moment, but it is clear that they must often have put a check on the more speculative class of business. This holds good particularly of private business, in a sphere where the individual with large resources has usually been considered best able to initiate pioneer work. Wider causes than taxation, however, and particularly the dislocation of our old export markets. must be held mainly responsible for the lack of buoyancy in recent years. Relatively, income taxation has not been a factor of high importance.

SUB-SECTION V: INCIDENCE OF THE DEATH DUTIES.

I.—*Estate Duty.*

452. In relating the total burden of taxation to the income of the individual we have treated all death duties as a charge mainly falling upon the deceased, or the predecessor (*para.* 229). As regards the most important of the duties—the Estate Duty—the theory that the incidence is upon the predecessor accords with the apparent intention of the legislature; for, as has been seen, the Estate Duty is graduated by reference to the aggregate value of the property passing, without reference to its destination or to the interests of the beneficiaries.

453. A rival theory, however, puts the incidence on the successor. It is of some practical importance to judge between the two, since the point at issue has a bearing on the equity of the duty. Equity rather suggests as the natural measure of liability the wealth or circumstances of the person—whether predecessor or successor—on whom the burden falls.

454. On practical grounds, we think it is impossible to say that the incidence of the Estate Duty is uniform.

If a testator has consciously stinted his expenditure and saved more year by year than he would otherwise have done, regarding the difference solely as a piling up of the tax against the day of his death, it is hard to deny that the incidence is upon him during his life.

If, on the other hand, the feelings and action of the testator have not been influenced in any direction by the prospect of the duty, the successor is the only person who suffers and the only person to whom the incidence can well be assigned.

455. The difficulty is that, apart from outward evidence not usually available, such as deliberate insurance, no-one can precisely gauge what is in the mind of the predecessor. Generally speaking, we do not think the prospect of the Estate Duty has so much influence on work or saving as the annually recurring Income Tax. On the other hand, we think it undoubtedly affects the behaviour of many people, whether their wealth is, e.g., in a business which they are building up themselves, in a landed estate, or in stocks and shares which they have inherited. It can be argued that in the last case provision for payment of duty is a good deal less likely to be made than in the first two, but this is very much a matter of individual judgment.

456. Certain more general considerations require to be mentioned, but these again are indecisive. In favour of the view that the duty is on the successor it may be pointed out that it is not paid by the predecessor, that there is no liability till he dies, and that he is free to ignore the duty if he wishes, while the successor, as a hard matter of fact, comes into so much less than he would have done, and has no kind of redress.

457. On the other side, it may be answered that the subject of taxation is, after all, the property which has been held or accumulated by the deceased, and that the tax has fallen upon him, in the sense that it has affected the amount of which he could dispose.

Further, the mere fact that the duty diminishes the property into which the successor may enter is no proof of its incidence being on the successor. There is no absolute distinction between the Estate Duty and the Income Tax in this respect; the Income Tax, so far as it takes away income which would have been saved, is a tax on potential capital, retarding the accumulation of wealth and diminishing the estate which can be left on death, yet no one hesitates to ascribe the whole of its incidence to the predecessor.

458. In fact, when one compares the Income Tax with the Estate Duty, regarding the latter as a kind of postponed Income Tax, one sees clearly the solidarity of the interests of predecessor and successor. The Income Tax, in a concealed way, hits the

taxpayer's son as well as the taxpayer himself, and may hit him just as severely. But the damage is separated by a time-gap. In the case of the Estate Duty the time-gap is bridged, and the damage is at once apparent.

459. On the whole, we think we have good support for giving primary but not exclusive place to the notion that the incidence of the duty is on the predecessor. This idea was present at the inception of the duty in 1894, when the Chancellor of the Exchequer (Sir William Harcourt) said, "The graduated Estate Duty may be, in fact, reckoned in terms of an annual charge upon the estate, and in that shape may be regarded as a graduated Income Tax, which is levied only upon realised property, and does not fall upon what are called 'precarious' incomes. So that, in point of fact, you do arrive at the result which is aimed at in the demand for a graduated Income Tax falling upon what are called 'spontaneous,' as distinguished from 'industrial' incomes." In 1906 the same idea was expressed in a paper put before the Select Committee on Income Tax then sitting. The paper, which was handed in by Mr. (now Sir Bernard) Mallet, at that time a Commissioner of Inland Revenue, embodied tables illustrating the burden upon incomes of the Income Tax and the Estate Duty. The Estate Duty was treated as equivalent to an annual insurance charge upon the "unearned" income of the predecessor, just as in paragraphs 229 *et seq* of this Report. A prefatory note explained that the object was "to consider the Income Tax and Estate Duty, if possible, in their relation to each other as different forms of the taxation of income, bringing out the effect of the latter tax as an additional tax on the income from property."

Since 1906 differentiation between earned and unearned, or "investment," income has been introduced within the Income Tax, and similarly graduation according to size of income has been enormously extended and developed. The aspect of the Estate Duty, as introducing an element of differentiation in the taxation of income, has, therefore, been to some extent obscured.

460. In passing, we may note a third view, viz., that, strictly speaking, the Estate Duty has no personal incidence at all, merely falling upon the estate as such. This theory has some theoretical cogency, and historical support may be found for it in the old idea of the State as the common heir of all men. For practical purposes, however, it is clearly necessary to relate the incidence to some individual.

II.—*Legacy Duty and Succession Duty.*

461. These minor duties are in the nature of acquisition duties on the beneficiary. A testator who looks forward to leaving his property to his wife or children, and who sets

himself to work harder or to save more in order to provide for payment of Estate Duty, is likely also to take these duties into account (the rate payable where property passes in direct line is only 1 per cent.). He is less likely to attempt to make provision as regards any property going to a brother or sister (in which case the rate would be 5 per cent.), or to a cousin or friend (in which case the rate would be 10 per cent.). The main yield of the duties is from the 5 per cent. and 10 per cent. rates. No account is taken of the inheritor's wealth. (*cf. para.* 539.)

The intention is that the duties should fall upon the person receiving the benefit, and we think that, in fact also, the burden should generally be regarded as falling upon him.

SUB-SECTION VI: EFFECTS OF THE DEATH DUTIES.

Introductory.

462. We have found a remarkable diversity of opinion among our witnesses as to the merits and demerits of the death duties. Sir Felix Schuster, for instance, described them as " a very injurious form of Capital Levy " (*Ev.*, p. 10; *E. in C.*, 12); Lord Hunsdon said of them that they seemed to him " to have almost every defect that a tax can possess " (*E. in C.*, 6). On the other hand, many witnesses had no particular complaint against the death duties as compared with other taxes; Mr. R. H. Brand, for example, considered that, in important respects, it was " difficult to draw a hard-and-fast line between the effect of death duties and the effect of a very high Income Tax " (*E. in C.*, 9); Mr. McKenna, while he thought that " the death duties impose great hardship and inconvenience upon the individual " (Q. 1931), regarded some of the principal allegations as to their damaging effect upon the community as ill-founded (Q. 1920 et seq.); the Co-operative Congress considered that " the merits of death duties far outweigh the disadvantages they create for individuals " (*Ev.*, p. 306; *E. in C.*, 23); and the economist witnesses were generally well-disposed to the duties in principle, even when criticising them in form or detail.

463. We propose to deal first with the Estate Duty, which is far the most important part of the death duties system. The framework of our discussion is as follows :—

	Paragraphs
I. The post-war rates of Estate Duty and the weight of the burden	464-474
II. The equity of the Estate Duty	475-495
III. The treatment of life insurance policies	496-497
IV. Avoidance of duty	498
V. Special cases :—	
(i) The private business...	499-504
(ii) The agricultural landowner ...	505-512

VI. The effect of the Estate Duty on saving and enterprise :—
(i) Physical effects 513-524
(ii) Psychological effects 525-532
(iii) Total effect 533-534
VII. The Legacy and Succession Duties ... 535-540
VIII. The Death Duties and Government Expenditure 541-544
IX. Summary of main conclusions 545-548

I. *The post-war rates of Estate Duty and the weight of the burden.*

464. A table showing the rates of Estate Duty in force, 1909-10 to 1925-26, is included in Appendix VIII.

The following figures, showing for Great Britain the numbers of estates for certain ranges of value, and the net receipt of duty from each, may help to illustrate the pre-war and post-war position. The official pre-war and post-war figures of duty are computed on bases which very slightly differ; the difference, however, is not such as to affect the validity of the comparison.

Numbers of liable estates and net receipt, Great Britain.

	Average of 1911–12 to 1913–14.		Average of 1920–21 to 1922–23.		1923–24.		1924–25.	
	Number of Estates.	Net Receipt.	Number of Estates.	Net Receipt.	Number of Estates.	Net Receipt.	Number of Estates.	Net Receipt.
		£ thousands.		£ thousands.		£ thousands.		£ thousands.
Not exceeding £1,000 net	43,548	253	61,652	382	64,206	391	67,918	414
Exceeding £1,000 and not exceeding £5,000...	14,451	1,137	22,636	1,814	24,378	1,919	25,855	2,025
„ £5,000 „ „ £10,000...	3,182	1,030	4,808	1,634	5,209	1,761	5,721	1,894
„ £10,000 „ „ £50,000 ..	3,250	4,134	4,560	7,841	5,073	8,867	5,418	9,443
„ £50,000 „ „ £200,000...	613	4,816	765	10,789	890	13,015	873	13,335
„ £200,000 „ „ £500,000...	77	2,667	91	7,068	115	8,428	120	9,353
„ £500,000 „ „ £1,000,000...	20	1,924	20	4,087	20	5,097	29	4,808
„ £1,000,000...	9	2,929	12	10,227	9	10,327	13	9,242
Total	65,150	18,890	94,544	43,842	99,900	49,805	105,947	50,514

465. The aggregate net capital value of all liable estates averaged £271 millions for 1911-12 to 1913-14, and £402 millions for 1920-21 to 1922-23; for 1923-24 it was nearly £442 millions, and for 1924-25 a little over £461 millions. For 1911-12 to 1913-14 over 79 per cent. of the total related to estates exceeding £5,000; for 1920-21 to 1922-23 the corresponding percentage was over 78; for 1923-24 and 1924-25 it was 79.

466. As in the case of the parallel Income Tax figures (*para.* 335), the high post-war yield in the case of the wealthy and the inequality in the distribution of wealth leap to the eye. It is

also interesting to note that, in spite of the fluctuations in values and prices since 1913, the net accumulations in nominal values during and since the War have not altered the proportion between the value of estates under £5,000 and those over £5,000.

467. The scheme of progression in the Estate Duty may be roughly compared with that in the Income Tax by showing the effective rates in pence per pound (i) of Estate Duty on estates of principal value ranging from £5,000 to £2,000,000, and (ii) of Income Tax and Super-tax payable by a married man with no children on investment incomes equivalent to 5 per cent., 7½ per cent., and 10 per cent. respectively of those estates. This is done for the scale of duty as modified by the Finance Act, 1925, in the graph in Appendix XVI. It should be noted that, strictly, the Estate Duty progresses by a series of steps, but for purposes of comparison the line of the graph has been smoothed out.

It will be seen that the progression of the Estate Duty is very slight at first, while the Income Tax rises strongly. Up to estates of about £15,000, the Estate Duty continues to be much the flatter; then, up to estates of about £150,000, the curves do not differ very markedly; from £150,000 up to £1,000,000 the Estate Duty drops away from the Income Tax, and then rises again sharply up to estates of £2,000,000, while the Income Tax is becoming nearly level.

It may be noted that, for deaths prior to the 1st July, 1925, the graduation of the duty would be considerably less steep above the £25,000 point.

468. Even when the Finance Act, 1925, is taken into account, the rates of Estate Duty have been less severely advanced over the pre-war level than the rates of Income Tax. Up to estates of £15,000 there was no change in the rate of duty till 1925, when 6 per cent. was substituted for 5 per cent. for estates between £12,500 and £15,000.

469. The following figures may be given, showing the liability of selected estates up to £12,500, passing on deaths after the 30th June, 1925 :—

Gross Value.	*Duty.*
£	
100	Exempt.
300	30*s.*
500	50*s.*
Net Principal Value.	£
1,000	20
3,000	90
5,000	150
10,000	400
12,500	625

For the effect of the duty on the successor it may be noted that, if a 5 per cent. yield is assumed, the duty reduces the income on the estate as follows :—

Estate. *Gross Value.*	*From*	*To*
£	£	£ s. d.
300	15	14 18 6
500	25	24 17 6
Net Principal Value.		
1,000	50	49 0 0
3,000	150	145 10 0
5,000	250	242 10 0
10,000	500	480 0 0
12,500	625	593 15 0

The burden from this point of view does not appear to be formidable, whether there is one beneficiary or whether there are several.

Again, from the point of view of the predecessor, the duty in these ranges is very light when reduced to terms of an annual tax (*see tables in para.* 234).

470. The illustrative figures of the preceding paragraph may be continued for larger estates.

Net Principal Value. £	*Duty.* £
20,000	1,600
50,000	7,000
100,000	19,000
150,000	33,000
200,000	46,000
500,000	135,000
1,000,000	290,000
2,500,000	1,000,000

The duty reduces a 5 per cent. yield on the estate as follows :—

Net Principal Value. £	*From.* £	*To.* £
20,000	1,000	920
50,000	2,500	2,150
100,000	5,000	4,050
150,000	7,500	5,850
200,000	10,000	7,700
500,000	25,000	18,250
1,000,000	50,000	35,500
2,500,000	125,000	75,000

For estates of £20,000 and £50,000, the burden, whether considered from the point of view of the predecessor or of the successor, cannot be called severe.

For estates of £100,000 and £150,000 it is much heavier, and the owners of such estates, if their total income ranges between £5,000 and £15,000, are also situated on a highly progressive part of the Income Tax scale. For larger estates the duty continues to progress, but less steeply. The predecessor has to save an increasingly large proportion of his income, if he is to make adequate provision for the duty in addition to paying his Income Tax and Super-tax (*see tables in para.* 255).

471. For a complete picture of the death duties it is necessary also to bear in mind the Legacy and Succession Duties. These minor duties are dealt with in paragraphs 535-540 and their effect, side by side with that of the Estate Duty, is very roughly illustrated in the tables in paragraph 234.

472. It was represented by Sir Felix Schuster giving evidence in May, 1924, that " if you go on taxing the same estates once or twice and taking the proceeds into revenue, then ultimately the estate disappears and the revenue is no longer produced. I think that is a distinct loss of capital. You cannot trace it out in the figures; it takes a long time. What I feel about the death duties is that we are only having the first crop, as it were, of death duties at their scale since 1909. We have not seen the effect on the same estates in the next generation and the generation afterwards. I think statistics, therefore, do not show the consequences of the 1909 Budget yet, in particular as the War has produced a good many colossal war fortunes." (Q. 113).

473. We cannot believe that the future will justify this estimate of the duty's effect. In particular cases of landed property (*cf. paras.* 505-12) or of quick succession (*cf. paras.* 481-4), the damage may be severe, and a single exaction may contribute to the break-up of an estate. A large agricultural property, for example, is not likely to retain its character as a single estate for many generations, unless the successive owners have a considerable amount of personal property as well. On the other hand, in the case of a property not consisting wholly or mainly of land, it would take many generations to " destroy " a property, even if, contrary to the usual association of age with wealth, the capital value of the property between the series of deaths be taken as remaining constant: for, as the estate is diminished, the rate of duty applicable to it also diminishes. For purposes of illustration, the following table shows the result of applying the present rates of duty to an estate of £2,500,000,

passing once every 30 years, in other respects remaining constant in value and transmitted on each occasion to a single heir :—

—	1925 (after 30 June).	1955.	1985.	2015.	2045.	2075.
	£	£	£	£	£	£
Principal Value of estate passing.	2,500,000	1,500,000	1,020,000	714,000	514,080	370,138
Rate per cent. of duty under present scale.	40	32	30	28	28	26
Net amount of estate. transmitted.	1,500,000	1,020,000	714,000	514,080	370,138	273,902

It will be seen that it takes 150 years, after the estate has been reduced from £2½ millions to £1½ millions, to bring it below £300,000. The history of an estate depends in reality, on a great many factors, including, e.g., the number, character and ability of a testator's children. If the general factors make for dissipation of the estate, the Estate Duty will, of course, assist in the process. But its part, under the present scheme of graduation, can only be very limited.

To a certain extent the duty may be held to make for the survival of the fittest. In very many cases, recovery in capital value will take place in the interval between successive deaths; further, the toll taken by the duty may itself act as an incentive to the successor.

474. A word may be added regarding the case where an owner of wealth just contrives to meet his Income Tax and Super-tax, and pay current expenses, without laying by anything against the Estate Duty. In such circumstances the Estate Duty will eventually decrease the value of the property. It is hardly fair, however, to hold the Estate Duty alone responsible, and to exonerate the yearly taxes. But for the weight of the latter, it is likely that something at least would have been saved and would have helped to preserve intact the original net value of the estate.

II *The Equity of the Estate Duty.*

475. In the case of the Income Tax it has been seen (*para.* 332) that progressive rates are in the main justified by the principle of the diminishing utility of income. In so far as the Estate Duty is regarded as a deferred Income Tax on investment income, the progressive scale has the same sort of justification.

476. The Estate Duty, however, being charged on a capital base, can only in a limited sense be spoken of as a tax on income;

it applies a different test of ability to pay, and provides for an important element of ability which an Income Tax cannot recognise, except in the most inadequate way.

This may be made clear by an example. Let A, B and C be three individuals, each with an income of £5,000. Let A's income be from earnings, B's from a speculative holding of shares worth £50,000, and C's from £100,000 of gilt-edged securities. Both B and C are enormously better off than A, and C is very substantially better off than B. A has nothing but a power of earning so long as he is able to work; C, apart from the same income, has £100,000 which he can spend, if he wishes, or can leave intact to his successors, and he need have no financial uncertainties at all. If there were no Estate Duty, the yearly earned income relief of £250 given by the Income Tax would be the only differentiation in favour of A; it would obviously be entirely inadequate. A substantially higher differentiation calculated to meet the equities of the case would be very difficult to work, if only on account of the inter-mixture of the capital element in many earned incomes, while the rate of Income Tax and Super-tax on investment income would have to be put excessively high. The Estate Duty not only indirectly makes the desired differentiation between A and C, but it also distinguishes in a satisfactory way between B and C. C has £5,000 gilt-edged rate of interest; B has £2,500 gilt-edged rate of interest, plus £2,500 insurance against the risk involved in his speculative investment; in prudence he ought to put a large part of his income by as a sinking fund against possible loss. Nevertheless, under Income Tax and Super-tax, B pays exactly the same amount as C. This kind of maladjustment may be said to be put right to a substantial extent by the lower rate of duty on the lower amount of B's capital when it passes on death.

477. The basis of the Estate Duty supplements that of the Income Tax in a further way, in that it extends to assets such as jewels, pictures, motor-cars, &c., which do not produce any money income; it also catches increases of wealth due to capital transactions, speculation, the unearned increment in land values, &c.

478. Generally it may be said that any single test of ability to pay, whether it be amount of income or of capital, of savings or of expenditure, or anything else, is bound to have many defects. Although it may be held that the amount of income is much more satisfactory than other tests, it is not comprehensive. This being so, there is a *prima facie* case for saying that a system of direct taxation which relies on the best individual basis for its primary yield, and on a quite distinct basis with merits of its own for a substantial secondary yield, is likely to contain advantages which could not be present in a system resting upon one basis only.

479. Thus, on broad grounds, there is a great deal to be said for the equity of the Estate Duty, when viewed in relation to the existing system. Some witnesses noted as a theoretical defect the failure of the duty to discriminate between wealth inherited by the deceased and wealth acquired by his own work and saving. The Income Tax has a similar shortcoming in relation to income from investments (*cf. para.* 356), but it may be that a remedy is more practicable in the case of the Estate Duty. A far-reaching proposal has been made by Professor Rignano for taxing the two classes of wealth differentially, but his scheme, which we notice in paragraphs 921-28, has not hitherto been given a trial in any country.

480. From the fact that it is levied at an arbitrary point of time, the Estate Duty is in many ways a good deal less capable than the Income Tax of nice adjustment to the taxpayer's ability to pay; this disadvantage may be dealt with under four heads :—

(i) the varying frequency of deaths;
(ii) the indefinite variation in the history of the growth of estates;
(iii) fluctuations in security values;
(iv) changes in the scale of duty.

Afterwards it will be necessary to consider briefly the special point of view of the successor.

481. *The varying frequency of deaths.*—It is clear that, when comparable estates are taken, the burden of Estate Duty will be heavier or lighter, as the deaths giving rise to liability are more or less frequent. This inequality as between one estate and another will tend to create some unfairness to individuals, although the unfairness, where it exists, will differ in degree according to every kind of circumstance, and will not be felt in the same way as if the duty were a direct tax paid by living persons. A measure of relief is accorded, in the case of land or of a business other than a company, where the property passes a second time within five years (Finance Act, 1914, Section 15).

482. It may generally be said that the case of quick succession is the exception rather than the rule, although property will, of course, pass more frequently where it goes to collaterals than where it goes in direct line. An estimate has been given to us by the Inland Revenue Department that, out of the 6,000 or so estates exceeding £10,000 which pass each year, about 3 per cent. pass again within the next five years. The Department think it not altogether unlikely that a further 5 per cent. may pass within a second like period and a further 7 per cent. or 8 per cent. in a third like period, i.e., 15 per cent. or 16 per cent. may pass a second time within 15 years.

483. To a certain extent variations equalise out in the long run. This point, however, must not be pressed too far. There are so many variable factors in the history of estates, and the

rates of duty are (to judge from the past) so liable to variation, that the future cannot be trusted to make amends for any present inequality. Nevertheless, it is fair to observe that quick succession may often be due to the first of the two persons deceased having enjoyed the estate for an exceptionally long period. He may have built up a business over a long term, and have died at the age, say, of 80, leaving his property to his son, then aged 50, who may have died within the next five or 10 years, being succeeded in turn by his son, a young man of 25 or 30 with a life expectation of 40 or 35 years. Against the repetition of the burden within five or ten years must be set the long freedom of the estate from duty during the life of the first deceased, and the prospect of a further good period of immunity.

484. So far as the duty on an estate is covered by life insurance, the estate may be preserved intact, irrespective of the life of the decedent. To this extent the inequality is modified.

485. *The indefinite variation in the history of estates.*—This consideration follows from the last. Even if the cases are taken of two men, each of whom, on reaching the age of 40 in the same year, inherits an estate of £20,000, and each of whom, on dying at the age of 70 leaves an estate of £100,000, the burden of the duty may not from their point of view have been the same. The estate, and the income from it, may have grown rapidly in one case and gradually in the other; the income enjoyed over the 30 years will have differed, and the Income Tax year by year will have been adjusted to the changes. The Estate Duty on the other hand, although it may be regarded as a kind of " deferred Income Tax," ignores the interval, and the charge is the same, irrespective of difference in ability to pay, as measured over that interval.

486. *The fluctuations in security values.*—A rise in the market rate of interest means a fall in the capital value of fixed interest securities, and *vice versa.* These securities form a much greater bulk than variable interest stocks, but even the latter are affected to some extent by changes in the rates of interest. The value of estates for Estate Duty purposes may be materially affected.

487. A property yielding a fixed return of £5,000 is from an income point of view just as good when the current rate of interest is high as when it is low. So far as fluctuations in the rate are only temporary, the value of the property may hardly be affected even from a capital point of view. But for Stock Exchange, and so for Estate Duty, purposes, the £5,000 income may, within a short period of fluctuating values, be represented by a capital value of £100,000 in one year and of £120,000 in another. The burden of the duty may depend to an appreciable extent on the date of a man's death, even if the scale of the Estate Duty is unaltered.

488. Fluctuations in value have been abnormal in their extent and rapidity since 1914, and figures from recent years have to be taken as exaggerating the position in the long run. With this caution, however, we may trace the effect of varying rates of interest in a comparison of the year 1920-21 with the year 1923-24.

In the calendar year 1920 the average discount rate of the Bank of England was 6·71 per cent., and in 1923, 3·5 per cent. The average price of Consols was £47 in 1920 and about £57 in 1923.

In 1920-21 the aggregate gross capital value of estates paying duty in Great Britain was £409,200,375, of which Government and municipal securities totalled £72,211,978 and stocks, shares, etc., £111,937,985. In 1923-24, the aggregate gross capital value was £479,361,544, or £70 millions in excess of the 1920-21 figure. This excess is almost entirely accounted for by the increased value of securities, etc. Government and municipal securities totalled £107,571,243, and stocks, shares, etc., £144,896,391, the former exceeding by £35½ millions, and the latter by £33 millions, the corresponding 1920-21 figures.

489. *Changes in the scale of duty.*—These introduce further inequalities. Thus wealth accumulated in the same period, e.g., the years 1903-1913, will have suffered very differently in different estates, according to the date of death (*see the table of rates in Appendix* VIII). Here again, however, the period from 1913 onwards cannot be taken as representative. A contrast is furnished by the period 1894 to 1909, during which the scale of duty was practically unchanged.

490. *Equity from the point of view of the successor.*—The graduation of the Estate Duty is only accidentally and uncertainly related to the ability to pay of the successor. The beneficiaries may be rich or poor; there may be one, there may be several. Such considerations do not affect the duty; an estate divided among several children pays no less heavily than an estate of the same size passing to one; a poor beneficiary suffers as heavily as a millionaire on a benefit of the same amount.

491. More than one witness criticised the Estate Duty on these grounds. Both Sir Felix Schuster (*Ev.*, p. 10; *E. in C.*, 12 and Q. 113) and Professor Cannan (*E. in C.*, 16) were very definitely in favour of taxing by reference to the inherited share rather than to the whole estate. It would be natural to accept this opinion, if the duty were regarded simply as a tax upon the successor; from that point of view there is force in Sir Felix Schuster's remark that "it does seem rather inconsistent with the present principle of taxation—that you tax a man according to the burden he can bear—that, if you have one estate divided into five parts, the five parts should pay on the same scale as if the estate went to only one part." (Q. 113). But, as we have

seen, the Estate Duty is in origin and idea rather related to the predecessor. There does not seem to be anything inherently unfair in the notion of a deferred tax on investment income including " income of enjoyment " from jewels, pictures, etc. So far as the Estate Duty is in the nature of such a tax, it is *prima facie* fair that it should be graduated according to the wealth of the person who has enjoyed the income.

492. The Estate Duty may be no more damaging to the successor than an Income Tax which the predecessor has borne. Indeed, if the predecessor has assumed the whole burden of the duty by stinting himself or working harder, the beneficiaries are not in reality hurt. On the other hand, even in such a case, the burden seems on the face of it to be closely and obviously related to the beneficiaries. To graduate the duty without any reference to the number or wealth of these has, for many people, an appearance of inequity.

493. This appearance of inequity is in itself a defect. But further, it may be argued that the inequity is real, so far at least as the predecessor has taken no steps to bear the duty himself. It may be said that the parallel with the Income Tax breaks down, owing to the difference in time. While the Income Tax may seriously affect the taxpayer's heirs, whether it does so or not depends on the future which cannot be foreseen. On the other hand, when the Estate Duty comes to be levied, the circumstances of the heirs are known, and the advantage of a tax levied at that moment is that it enables those circumstances to be taken into account.

494. We think that this argument in favour of the inheritance tax principle is not entirely without force.* At the same time there is some justification for looking on wealth acquired by inheritance as in the nature of a windfall, the taxation of which does not call for the same nice adjustment as the taxation of income towards the existence of which a man has himself contributed.

495. *Conclusion.*—We conclude that, on balance, the equity of the Estate Duty can well be vindicated. The duty is indeed open to criticism in many respects, especially when viewed in isolation. As a part of the tax system, however, it is seen to be a valuable supplement to the Income Tax. The two forms of taxation together provide a fuller criterion of ability to pay than the Income Tax alone could furnish.

It may be added that a tax payable on an estate in transit does not appear to require so meticulous a standard of equality as a tax levied directly on the living taxpayer The burden is, in general, less acutely felt.

---

* We refer in paragraphs 1024–7 to the question whether this principle should be given a wider application.

III.—*The treatment of life insurance policies.*

496. It is not infrequently suggested that a hardship arises from the treatment of the capital sum assured under a life policy as part of the principal value of the estate. " In partnerships and in the case of large estates," said Mr. Beaumont Pease, " death duties are largely provided for by life insurance out of income. It has always seemed to me that it is a great hardship that such provision made out of income should itself be subject to death duties, and should, in many cases, actually increase the rate of such duties payable by the estate. I think it would greatly encourage the provision for such duties by insurance, which, economically, is a very sound thing to do, if the provision itself were exempted, subject to proper limitations and safeguards " (*E. in C.*, 21). Lord Clinton, representing the Central Landowners' Association (Q. 318), and Sir Felix Schuster (Q. 113) spoke of the treatment of policies as making people unwilling to insure.

497. There seem to be two questions for consideration, (i) whether in this respect the Estate Duty law is discouraging to thrift, and (ii) whether it is inequitable. Life insurance is one among many ways in which individuals may save, and capital sums accumulated by any kind of saving are within the Estate Duty charge. It is true that certain special considerations apply to life insurance. Thus, in justifying Income Tax relief in respect of premiums, the Royal Commission on the Income Tax pointed out that " the distinguishing feature of life insurance, which probably accounts for what would otherwise seem to be an unfair preference, is that by no other means can the less wealthy taxpayer, who has no accumulated capital in his earlier years of productive effort, secure a proper provision for his dependants." (Cmd. 615, para. 296.) Would this argument justify further concessions to the taxpayer, to say nothing of further benefits to insurance companies? The relief enjoyed in respect of Income Tax is very considerable, and " the less wealthy taxpayer " is subject to comparatively low rates of Estate Duty. If relief were given for Estate Duty purposes, a great part of the gain would go to the wealthier taxpayer, who would no doubt be induced to insure more freely. Altogether, it is our opinion that differential relief in favour of this particular form of saving would not make for equity : moreover, it is open to doubt how far it would be in the interests of industry that the savings of the wealthy should be specially encouraged to flow into insurance, since this might involve some diversion from the more speculative investments to gilt-edged non-pioneering funds.

IV.—*Avoidance of Estate Duty.*

498. The subject of tax avoidance or evasion is one which we are not specially called upon to examine, but we cannot omit reference to it in dealing with the Estate Duty. All direct

taxation depends very largely for its success on the assent and good feeling of the taxpayer. Apart from illegal or fraudulent evasion, there is always a danger that, if taxation is pressed beyond a certain point, even law-abiding citizens may feel themselves justified in adopting legal methods of avoidance. The special liability of the death duties to avoidance was commented on by several witnesses (cf. Qs. 814, 3605, and 9129), and we agree in regarding it as a marked defect. We refer in a later section to the possibility of checking it (*para.* 1022). but we may say at once that in our opinion the rate of Estate Duty on large estates is, from the point of view of the effectiveness of that rate, already dangerously high.

V.—*Special cases.*

(i) *The private business.*

499. Some of the chief strictures passed upon the death duties have related to their direct action upon trade and business. Public limited companies, indeed, are not directly affected, since the duties are levied only on the estate of a deceased individual. But private concerns, whether firms or companies, financed by a very few individuals or by a single individual, feel the immediate impact.

500. The Association of British Chambers of Commerce observed that "death duties dissipate and divert capital from business channels often at a critical moment in the life of a concern, and make serious inroads on the credit of those affected." (*Ev.*, p. 291; *E. in C.*, 66.) Professor Macgregor also referred to the " awkward times " at which small businesses may be hit. (*E. in C.*, 25.) The National Chamber of Trade stated that " businesses and undertakings passing at death from father to son in quick succession have in some cases been seriously crippled, and have actually ceased to be sources of income at all." (*E. in C.; Ans.* 12.) Lord Forres thought it clear that " the death duties affect private business very seriously and much more so than companies. It has now become a risky matter to have too rich a partner. Death is uncertain and may come at the most unexpected time and at the most inconvenient and embarrassing moment for the firm. However considerate the provisions of a deceased partner's will may be, and even if he had a son who might succeed him in the business and become entitled to a portion of his means, the demands of the Inland Revenue must be met, usually from liquid resources employed in the firm, and, in the case of a large fortune, are so heavy as to upset and in some cases to embarrass the business." (*E. in C.*, 4.) Sir Felix Schuster said that " the duties can in most cases only be paid through bankers' advances, which take a long time to repay, and the effect on the business must necessarily be very serious and hamper its work and development." (*Ev.*, p. 10; *E. in C.*, 12.)

Mr. McKenna, however, thought most private businesses made provision in advance (Q. 1929), and several other witnesses expressed similar opinions, referring especially to life insurance.

501. There is no doubt that the Estate Duty (the Legacy and Succession Duties contributing in a very minor degree) does have embarrassing and serious effects in individual cases. It is therefore essential to enquire how frequent those cases are. Mr. McKenna suggested that " the number of large private businesses likely to tbe involved heavily by death duties is small," most big businesses being public companies (Q. 1926). Large private concerns are, however, numerous enough to make the matter serious, if all or most of them are badly hurt by the duties. The extent of the damage depends very largely on the proportion of estates where there are not enough free assets outside the business to provide for payment. Lord Forres, in his evidence quoted above, had in view the case of a partner the whose or practically the whole of whose fortune is invested in his business. He assented to a suggestion that that case was not uncommon (Q.7793-4).

502. In view of the importance of this question we asked the Board of Inland Revenue whether they could help us with any statistics. The Board carried through a very detailed and thorough analysis of all estates exceeding £10,000 net capital value, and including trade assets, which came before them in the first quarter of 1922. The results of this analysis were embodied in a note printed as Appendix XX. They are, we think, surprising. The number of estates analysed was 373. When the estate debts were apportioned evenly over all the assets, it was found that in 308 cases the net trade assets were less than half the net estate. Of the remaining 65 estates there were only 3 where the net non-trade assets were less than the duty on the whole estate, of which 2 occurred in the range of net capital value from £25,000 to £50,000, and 1 in the range from £50,000 to £100,000; none occurred, that is to say, among the estates (38 in number) belonging to the range of fortunes over £100,000, which, it has been suggested (cf. Q. 113), are of special importance to the country's trade. Even when all estate debts were treated as if they were a charge on the non-trade assets, in only 12 cases was the net amount of those assets insufficient to meet the duty on the whole estate. Of those 12, 8 were in the range from £10,000 to £25,000, 2 in that from £25,000 to £50,000, 1 in that from £50,000 to £100,000 and 1 in that from £100,000 to £250,000.

503. In other words, out of the 373 estates, only 0·8 per cent. according to the first test, and only 3·2 per cent. according to the second (unduly severe) test, were cases in which it was clear that the Estate Duty need entrench upon the trade assets. We agree with the Board, on the evidence of their statistics, which also include figures relating cash and liquid assets (excluding

realty and leasehold property) to duty payable, that, while cases of hardship undoubtedly occur, " the Estate Duty does not appear to be a major factor tending towards the disintegration of private businesses (*para.* 19 of Appendix XX).

504. Many witnesses remarked on the tendency of the death duties to cause the conversion of private concerns into public companies. Mr. A. M. Samuel especially regretted this tendency, owing to the value of personal touch and supervision in the former (Q. 1007). Dr. Dalton, on the other hand, was " in favour of anything which accelerates the transformation " (Q. 5551). It is difficult to form an opinion as to the strength of the tendency. Some witnesses were inclined to emphasise it : Lord Forres did not consider it of much importance as compared with other agents in the change. In view of the considerations set out in the last paragraph, we are not inclined to put it very high.

(ii) *The agricultural landowner.*

505. We received forcible evidence from the Central Landowners' Association, the Land Agents' Society, and the Land Union, regarding the plight of the owner of agricultural land. We also received a memorandum of similar purport from the Scottish Land and Property Federation (*Ev., Appendix* IV).

506. The general body of this evidence illustrated clearly the fact that, apart from local and imperial taxation, the expenditure entailed by a large agricultural estate is very heavy in relation to the money income which it yields. There is no doubt that high taxation contributes to the difficulties of maintaining land, and that it has played a part in the break-up of estates, and in reduced employment. It is not for us to say whether the break-up of estates (which must incidentally tend to bring the capital value of land into more normal relation with the income) is in the long run good or evil on balance. The effect on employment in country districts cannot, of course, be lightly regarded. At the same time it does not seem fair to assign the main responsibility to taxation rather than to the all-round level of expenditure. Indeed, since the taxes which the landowner pays are of general application, it might more reasonably be argued that what he has to blame is the heaviness of his necessary private expenditure, and not of his contribution to the expenditure of the State. We should add that, since we received evidence from the landowners' societies, increases have been made in the Estate Duty scale by the Finance Act, 1925, agricultural property being excepted, so far as concerns its purely agricultural value. To this extent. then, the agricultural landowner now occupies a privileged position.

507. The Central Landowners' Association put in the forefront of their case against the death duties that they " press with exceptional severity upon agricultural land, because it has

a market value relatively far in excess of its income-producing value, and also by reason of the basis of valuation adopted in practice " (*E. in C.*, 7). The second clause in this statement raises a technical question of valuation, on which we have not taken complete evidence, and on which we pass no judgment, since it appears to fall outside our scope (*cf. para.* 5).

508. The more important question centres on the low income-producing value of land. The Central Landowners' Association suggested that agricultural estates should be valued for death duties on a fair capitalisation of annual value. The low return on land as compared with other investments is undeniable, though, as Mr. Pretyman, President of the Land Union, reminded us, cases vary very much. " Say you buy a farm in the Fens; that has got absolutely no amenity at all; it is purely an investment. But if you buy a pretty piece of poor land in the southern counties, with a nice house on it and some woodlands, and an attractive view, that is all amenity as much as a picture " (Q. 5641). It is a root principle of the Estate Duty that it is levied on the value of capital assets, whether they yield a money income or not. We think it very undesirable that an exception should be made.

509. The Scottish Land and Property Federation supported, but the Land Union did not support, the particular suggestion that amenity value should be eliminated. Mr. Ernest Watson, agricultural and valuation expert to the Land Union, had other reasons against it " apart from obvious objections to putting owners of one form of property in a favoured position as compared with others." (*E. in C.*, 5-6.) Mr. Pretyman did not think a man who invests his money for amenity ought to get off taxes on that account. He considered, however, that relief should be given to agricultural landowners from the point of view of the national interest (Q. 5643). He and Mr. Watson made various specific suggestions, including a longer period for payment than the eight years conceded by existing law. This was also among the measures advocated by the Central Landowners' Association.

510. The Scottish Land and Property Federation maintained that the passing of the landed estate was " the annihilation of the tenancy system, under which the farmers of this country have been enabled to devote their whole capital to their farming operations, instead of locking up more than half of it in the land and equipment which are required therefor " (*Ev., Appendix* IV; *para.* 13).

511. Evidence from the Board of Inland Revenue tended to confirm the unfavourable position of agricultural landowners. Sir Richard Hopkins stated that, generally speaking, he should say that, " in the conditions which have obtained recently in regard to agricultural land, agricultural landowners have had singularly few opportunities, as compared with other members of the community with equal wealth, of saving out of income

for the purpose of meeting death duties " (Q. 9140). At the same time he gave statistics for a six-month period in 1921, relating to estates over £15,000, which went to show " that the number of cases where payment is specially difficult must be comparatively small " (Q. 9137). While he did not claim that the figures could be relied on as fully representative, he was satisfied that they gave a reasonable picture of the position. They seemed to show that about 2 per cent. of estates over £15,000 in value, i.e., about 100 estates a year, contain over 50 per cent. of agricultural land; about 4 per cent. of estates over £15,000, or about 200 estates a year, contain from 20 to 50 per cent. of such land. He added, however, that, were it not for many sales in recent times, partly in anticipation of death duties, he thought " one would certainly find that the number of estates of substantial size that consist almost exclusively, or very largely, of land would be very much higher than it is " (Q. 9138).

On the question of an extended period for payment, he was not impressed with any general insufficiency in the eight years allowed.

512. In general, we are opposed to tax relief provisions in favour of a particular class, either of industry or of individuals. The case put to us for relief of agricultural landowners rests largely on the general condition of agriculture, a remedy for which, it is to be hoped, may be found in other ways than by the undesirable expedient of tax remission. While we recognise that the Estate Duty, under present conditions, does weigh very heavily on the purely agricultural estate, we have reluctantly come to the conclusion that special relief from the duty—in which we include the existing relief (*cf. para.* 506)—is unjustifiable. Taking the available means of credit into consideration, we do not think that there is any clear case for an increase of the eight-year period allowed for payment.

VI. *The effect of the Estate Duty on saving and enterprise.*

513. In dealing with the effect of income taxation on saving and enterprise, we constantly took into account the fact that a considerable part of the Income Tax revenue is devoted to payments on account of the National Debt, from which the Income Tax paying class derive large benefits. In respect of Government expenditure under this and other heads, the considerations applying to Income Tax and Estate Duty are similar.* Consequently, in comparing the effect of the Estate Duty on saving and enterprise with that of the Income Tax, as we propose to do in this section, we may concentrate attention on the collection, as distinct from the expenditure, side of the account.

* We do not forget that a part of the Estate Duty (£9,807,334 in 1925–26) is allocated to Local Taxation Accounts. The assigning of this payment to the Estate Duty, rather than the charging of it against the general revenue, is essentially a mere matter of convenience.

(i) *Physical Effects.*

514. *The physical effect on saving.*—Estate Duty may, in the normal course, have to be paid out of the capital of the particular estate. From the collective point of view, however, there will be no loss of existing capital, for ultimately the source of payment will be somebody's income. The executors may have to sell securities in order to find the necessary lump sum. The immediate purchaser may take up those securities with the proceeds of some sale which he in turn has effected; there may, in fact, be a chain of transactions amounting to no more than a transfer of existing capital. But the chain must lead eventually to a purchaser who has savings out of income to dispose of; it is those savings out of income which ultimately provide for payment of the duty.

515. This means that £50,000,000 of Estate Duty, directly paid for out of the capital of a number of estates, cause £50,000,000 of savings which would have created new capital to be absorbed into old investments. Thus the physical effect of the duty, *at the time when it is levied*, may be regarded in two aspects:—

(i) While there is no destruction of existing capital (any more than in the case of a tax on income), there is a change of ownership.

(ii) Potential new capital, to the full amount of the duty, is prevented from coming into being.

516. Prior to the death on which an estate passes, the duty can have no physical effect; it does not physically compel the person in present enjoyment of a property to make any provision for future liability.

On the other hand, after payment of the duty, there is obviously a physical effect on the successor. If the yield of capital be taken as 5 per cent., £50,000,000 of Estate Duty will reduce by £2,500,000 the incomes of the beneficiaries. Some part of this £2,500,000 would have been spent on consumption; some part would have been saved.

517. Continuing to exclude all questions of psychological reaction, we may now compare the effect of the Estate Duty with that of the existing Income Tax, including Super-tax. It is generally true as regards Income Tax (except so far as it may be paid out of capital) that the person who would save nothing but for the existence of the tax, is compelled by it to save up to the amount of his liability; the person who would save something, but less than the amount of his liability, is compelled to save the difference. Thus £50,000,000 of Income Tax paid in any year will always be met to some extent out of economies which are literally forced upon the taxpayer. In other words, the physical effect of the tax will be to reduce consumption by £x, and to suppress potential new capital, not (as in the case of the Estate Duty) by £50,000,000, but by £50,000,000 − £x.

In succeeding years the Income Tax payers' income will, at a 5 per cent. rate, be reduced by £2,500,000 $-\frac{£x}{20}$

518. According to this illustration, the physical effect of the Estate Duty is to do £*x* more damage to saving than the Income Tax, up to the time when the taxes are paid.

After payment, the effect of the Estate Duty is to reduce the taxpayers' yearly *income* by $\frac{£x}{20}$ more than the Income Tax. In order to compare the after effect on *saving*, we have to consider who would have been likely to save the larger amount, the beneficiaries out of the £2,500,000 per annum which they have lost, or the Income Tax payers out of the £2,500,000 $-\frac{£x}{20}$ The answer depends very much on the relative graduation of the two taxes.

Let us take the existing scales; let the £50,000,000 of Estate Duty represent the total yield of that duty, and let the £50,000,000 of Income Tax represent so much taken *pro rata* from the yield of all the various grades of liable income and from the undistributed income of companies, etc.

Now in the case of the Estate Duty the £2,500,000 per annum would have gone to the beneficiaries of about 100,000 estates; something like 75 per cent. of it would have gone to the beneficiaries of about 1,000 estates exceeding £50,000 in value.

In the case of the Income Tax the £2,500,000 $-\frac{£x}{20}$ per annum would have been spread over the whole body of Income Tax payers, numbering some 2,500,000, except so far as it might have gone to swell company reserves, etc.

Allowance must be made for the saving that might have been effected by companies. It seems clear, however, that, even out of an equal £2,500,000, more would have been saved by the beneficiaries of estates than by the Income Tax payers, in view of the large proportion going in the former case to wealthy persons with a wide margin for saving.

519. It is fairly safe, then, when the purely physical effects are isolated and traced through from beginning to end, to conclude that the Estate Duty on the present scale is more damaging to saving than an equal amount of Income Tax and Super-tax taken *pro rata* from the various grades.

520. The same conclusion would hold rather more strongly, if the Estate Duty were compared with an addition to the standard rate of Income Tax, the additional tax being in substitution for the Estate Duty and yielding the same revenue. For an addition to the standard rate of Income Tax, without a corresponding increase in Super-tax, would weight the burden on the less wealthy, who have less capacity to save.

(On the same reasoning, the physical effect of the Estate Duty is no doubt *less* damaging to saving than that of an equal aggregate amount of Income Tax and Super-tax taken from the wealthiest classes, say from the 2,500 or so individuals who have incomes of over £20,000.)

521. *The physical effect on enterprise.*—This effect is largely parallel to that on saving, in the case both of the Estate Duty and of the Income Tax. There are, however, certain distinctions which affect the comparison between the two duties.

522. Up to the time when the taxes are paid, neither of them can have any physical effect on enterprise. The Income Tax, as we have noted, may physically compel a man to save, but it cannot physically compel him to work, So far, then, the Estate Duty is not at a disadvantage.

523. Both taxes may impose some physical check on enterprise, after payment has been made. Let it be supposed, as before, that £50,000,000 of Estate Duty reduce the incomes of the beneficiaries by £2,500,000. Some of that amount would have flowed into public companies, etc., and some would have been used in private concerns carried on by the beneficiaries themselves. If the physical effect of the Estate Duty is more damaging to saving than the effect of an equal amount of Income Tax and Super-tax, it is probably also more damaging to enterprise.

524. As regards private concerns, however, it has to be noted that the Income Tax impedes the enterprise of the successful trader, while he is in full career. The Estate Duty impedes the enterprise of his successors. The latter may not be so able or enterprising, and the restriction of their income may therefore do less harm. On average this is probably true to a certain extent, and in this aspect we think some advantage has to be allowed to the Estate Duty.

(ii) *Psychological effects.*

525. As with any other form of taxation, the questions have to be asked: How much will the Estate Duty stimulate people to work and save? How much will it discourage people from working and saving? It is only by striking a balance between the two forces that any attempt can be made to estimate the final effect.

526. The Income Tax, with its annually recurrent demand, cannot be overlooked by the taxpayer, and is likely to suggest even to the most improvident the question of cutting down consumption in order to meet it. The Estate Duty, on the other hand, is a tax which the person in present enjoyment of a property can ignore, and in point of fact, particularly as people are apt to take a sanguine view of their life expectation (*cf. Cannan, E. in C.*, 15), many do ignore it or, with every intent to make a provision, procrastinate in so doing. This point

was much emphasised by Sir Felix Schuster, who considered the Estate Duty "especially injurious because it falls on future generations and to a great extent the present is inclined to disregard its consequences" (*Ev., p.* 10; *E. in C.*, 12).

527. Some of our witnesses viewed this feature of the Estate Duty from a different angle, and saw it as an actual advantage. Thus Professor Pigou suggested that, as concerns the deterrent effect of taxes, "death duties are rather a good form of taxation, in that people are probably not discouraged from saving by thinking of the death duties as they are by thinking of an Income Tax on unearned income" (Q. 706). Similarly, Dr. Dalton believed that the death duties were far less discouraging than Income Tax to work and saving. He added that "on the other hand, the prospect of heavy death duties will stimulate those who are waiting for a windfall of inherited wealth to work harder and to save more than they would otherwise do" (*Ev., p.* 395; *E. in C.*, 16).

528. Another advantage of death duties was pointed out by Professor Macgregor: "It is also to be noted that the purpose of savings is not only to provide for posterity, but also to maintain and increase the personal standards of life, power and reputation of those who save; death duties miss these motives, while any form of alternative taxation will to some extent hit them" (*E. in C.*, 24). "I think a large part of saving in this country is due to a desire to have the industrial power which large shareholding gives" (Q. 5827).

It might be added that the desire to die rich, whatever the destination of the riches, is in some cases a motive force.

529. While not denying that the Estate Duty has a positive influence in both directions, now promoting work and saving, now discouraging them, we think that in general it is decidedly more neutral in its effect than the taxation of income. The owner of wealth does not suffer in his own person if he treats the future liability as non-existent; but in any case, the amount of liability is usually most uncertain, particularly in the case of younger men.

The man who is building up a business, or in any way making a fortune, cannot predict the date of his death or the value of the estate which he will then have accumulated, nor can he predict the financial needs of his successors, even if he knows who they are going to be. The rentier or landowner may be in a better position for prophecy, but he cannot tell how capital values will have appreciated or depreciated. Further, even if the value of the estate could be foretold, the history of the Estate Duty does not justify any great confidence that the rates of duty will remain fixed. All this uncertainty must weaken the influence of the duty on the man in present enjoyment of wealth. It must also weaken in some degree the influence on the expectant heir.

530. In order to follow out our comparison between the Estate Duty and the Income Tax we must attempt to answer two questions:—

(i) Is the Estate Duty more damaging to saving and enterprise, in its psychological effects, than an equivalent amount of the existing Income Tax taken *pro rata* from the yield of all liable incomes?

(ii) Is it more damaging than an addition to the standard rate of Income Tax would be (the additional Income Tax being in substitution for the Estate Duty)?

531. As we have noted, the bulk of the Estate Duty is levied on a small number of large estates, the duty on lesser estates being very light. On the other hand, a considerable part of the Income Tax is paid by a large number of individuals with incomes up to £2,000. Some of this Income Tax is provided by economies forced upon the taxpayer, which have nothing to do with psychological reactions. At the same time, no little part is provided out of voluntary efforts to work and save more; for, among the small and moderate incomes, the Income Tax tends on balance to exert a definite stimulus to work and save. This stimulus continues to have some force, although a diminishing force, in the higher incomes. The Estate Duty does not exercise so much influence in favour of work and saving, although it no doubt induces a certain amount of special saving (including extra life insurance), particularly on the part of those who expect to leave small estates.

As regards the wealthier classes, the psychological effect of the Estate Duty is possibly rather less adverse to saving than that of the Income Tax and Super-tax; we think it must, on the whole, be less adverse to enterprise.

532. We are inclined to answer the first question in paragraph 530 by saying that there is very little to choose between the two taxes; there may perhaps be a slight advantage with the Income Tax in the matter of saving, and with the Estate Duty in the matter of enterprise.

As regards the second question, we suggest there may be a balance of advantage in favour of the additional Income Tax; for large estates would be very greatly relieved by the disappearance of the Estate Duty, and the additional Income Tax substituted for it would, in the absence of any increase in the Super-tax, place a lesser burden upon them.

(iii) *The total effect on saving and enterprise.*

533. We may now summarise the broader conclusions to be drawn from the foregoing discussion. The physical effect of the Estate Duty on saving appears to be severe and to be more damaging than that of the existing Income Tax. The same is true, although to a rather less degree, of the physical effect of the duty on enterprise.

The psychological effect of the Estate Duty is comparatively slight. It does not either stimulate or discourage work and saving so much as the Income Tax. It is very difficult to say where, in point of psychology, the balance of advantage lies.

Taking physical and psychological effects together, we think that the Estate Duty is distinctly more damaging to *saving* than the Income Tax (although we do not suggest that the difference is great). This result is due in part to the inherent nature of the Estate Duty as a deferred tax, and in part to the fact that, under the existing scale, the bulk of the duty is drawn from the largest estates.

We doubt whether the Estate Duty is more damaging than the Income Tax to *enterprise*. On the whole, we are inclined to think it is rather less so.

534. To complete this comparison between the Estate Duty and the taxation of income, we may ask one more question. Is the total effect of the duty on saving and enterprise more damaging than a substituted Income Tax would be, *if that tax were confined to income corresponding (as closely as possible) with the capital on which Estate Duty is paid?* Let it be assumed that the tax would be graduated with similar steepness.

Under the yearly tax, those who lived wholly or mainly on investment income might, on balance, be stimulated (and in some cases even physically compelled) to effect some extra economies. On the other hand, the differentiation against income from savings as compared with earned income would be more obvious in a yearly tax than in a tax deferred till death. It seems probable, therefore, that to some extent, it would tell against saving out of earned income. In the larger estates the burden would be a serious addition to the Income Tax and Super-tax, and would be more depressing than the prospect of Estate Duty at the uncertain date of death.

Altogether we think that, in conjunction with the ordinary Income Tax and Super-tax at their present level, the Estate Duty is decidedly less damaging to saving and enterprise than a corresponding yearly tax would be, i.e., a tax as defined at the beginning of this paragraph, and bringing in an equivalent revenue. In so far, then, as the object of the Estate Duty is to differentiate against accumulated wealth, it can do so in a manner less prejudicial than a special Income Tax covering the same field.

VII. *The Legacy and Succession Duties.*

535. These are minor duties, complementary to the Estate Duty, charged not upon the whole corpus of an estate but upon

the interest which a person derives from property left to or devolving on him upon a death. The Legacy Duty applies to all moveable property of an individual dying domiciled in Great Britain. The Succession Duty applies to all moveable property, not liable to Legacy Duty, under a British settlement, and to all immoveable property in Great Britain.

The rate at which the duties are charged is determined solely by the relationship of the beneficiary to the author of the benefit. The existing rates are :—

1 per cent. where the beneficiary is the husband, wife, or lineal issue or ancestor of the author of the benefit, subject to exemption where the total value of the property passing does not exceed £15,000 or where the total individual benefit does not exceed £1,000, or in some instances £2,000.

5 per cent. where the beneficiary is a brother or sister, or a descendant of a brother or sister.

10 per cent. in all other cases.

536. We have seen (*para.* 461) that the incidence of these duties is mainly upon the beneficiary. They cannot, in general, be regarded like the Estate Duty as a deferred tax upon the predecessor, supplementing the Income Tax. Rather, they are acquisition duties, based on the idea that a person who comes into an inheritance may justly be asked for a special contribution to the needs of the State, and that, if the inheritance has in it something of the nature of a windfall, the contribution should on that account be at a higher rate. Practically, however, the duties are very much in the nature of an addition to the Estate Duty, going some way to differentiate the total burden according to consanguinity. In the main, the considerations affecting the Estate Duty affect these duties also.

537. The existing scheme of graduation, which disposes of all the degrees of relationship under three heads only, is rough and cannot be called scientific. But, within its limits, it recognises the main broad distinctions. The rate charged on brothers and sisters is substantial, especially in view of the fact that estates passing by collateral descent fall in more frequently than the average. The 10 per cent. rate, applying to less closely related beneficiaries, is justified by the fact that they have less natural expectation; in other words, the windfall element is greater.

538. The following tables show the yield of the duties in Great Britain for the year 1924-25. Taking the two duties together, it will be seen that more than half of the capital brought into charge related to benefits taken by husband, wife, or lineal issue or ancestor, while the duty relating to such benefits was less than one-fifth of the total.

Legacy Duty (Great Britain) 1924-25.

Legacy to	Rate of duty.*	Capital.	Duty.
	Per cent.	£	£
Husband, wife, or lineal issue or ancestor.	1	119,429,810	1,218,282
Brother or sister or their descendants	5	63,629,210	3,163,004
Other cases	10	27,698,430	2,773,758
Total	—	210,757,450	7,155,044

Succession Duty (Great Britain) 1924-25.

Succession by	Rate of duty.*†	Capital.	Duty.
	Per cent.	£	£
Husband, wife, or lineal issue or ancestor.	1	24,216,870	260,024
Brother or sister or their descendants	5	10,493,920	487,816
Other cases	10	4,471,590	453,141
Total	—	39,182,380	1,200,981

* A relatively small part of the duty was chargeable according to lower scales in force at the time of the deceased's death.

† In certain cases supplementary rates to a maximum of 1½ per cent. are chargeable except as between spouses.

539. The Legacy and Succession Duties take no account either of the amount of the benefit, or of the other wealth of the beneficiary at the time when he receives the benefit. Professor Cannan, who was dissatisfied with the existing scheme of death duties graduation, suggested that it would be better to base the progression, as in France, on the first of these two factors, combined, perhaps, with the second; he also recommended that " the old detailed scheme* of progression according to relationship should be restored in place of the very crude existing graduation, and the present confusion between progression according to amount and progression according to relationship should be tidied up ", (*E. in C.*, 16). This proposal appears to amount to the substitution of an inheritance tax for the whole of the existing duties, although in oral evidence Professor Cannan showed that his suggestion was meant to be rather tentative.† We refer briefly to the proposal for a single inheritance tax in paragraphs 1025-27.

* Prior to the Finance (1909-10) Act, 1910, there were 5 steps instead of 3.

† " I think, perhaps, by altering the system of progression a little, making it depend less entirely upon the one point, the magnitude of the deceased's property, and making it depend also on certain other considerations, it might be possible to do this [make avoidance less likely], but it is a matter that requires investigation and thought." (Q. 814).

540. If the Legacy and Succession Duties were the main duties chargeable on death, their basis would, it is clear, be totally inadequate. Even in their subsidiary position they are open to attack. We have dealt above with the criticism against the Estate Duty that it takes no account of the successor's ability to pay. The existence of the Legacy and Succession Duties amounts to an admission that the principle of the Estate Duty can to some extent be combined with that of an inheritance tax. Naturally, therefore, the question arises whether the Legacy and Succession Duties might not be developed, and whether they might not take account of other elements than the single one of relationship. We do not suggest that in their present form they give rise to positive inequity in any marked degree. It is rather that they appear to fall short of the standard which the idea of an inheritance tax suggests. It is, however, possible that considerations of productivity and of simplicity of administration, which are strong features of the existing system, may in present circumstances be decisive.

VIII. *The Death Duties and Government Expenditure.*

541. It is commonly held that the death duties should be earmarked for redemption of debt or for some other capital expenditure. Many of our witnesses expressed this view, although others were opposed to it.

542. The underlying reason for the view is usually that the death duties " come out of capital," and that, if they are spent as revenue, the country is " living on its capital " instead of its income. This argument is fallacious. We have seen that the Estate Duty (and the same is true of the Legacy and Succession Duties) does not destroy existing capital; what it does, on the collection side, is to prevent a certain amount of new capital from coming into being. In this respect it is not essentially dissimilar to the Income Tax.

This point appears to be recognised by some of those who advocate the earmarking of the duties. They emphasise, however, the seriousness of their effect on the supply of new capital, and urge this as a reason for not applying the proceeds to ordinary current expenditure.

543. It appears to us that there would be no special virtue in earmarking the duties to redemption of the debt, or to other capital expenditure which is, in fact, included in the Budget. At best it would seem to be a book-keeping transaction. Mr. Selfridge thought that it would have a good psychological effect. " It is really a matter of book-keeping, but there is the sentimental nature of it. People think that their estates are being taken to pay the pay rolls in Whitehall " (Q. 7181). We recognise that this suggestion has some force. To act upon it, however, would be to encourage the fallacious idea that the death duties are paid out of the nation's capital, while other

taxes are paid out of income. In any case, there are arguments of a practical nature on the other side. We agree with Mr. McKenna, who was opposed to any allocation, that it might be hampering to lay down " an arbitrary rule " (Q. 1920). This aspect of the question was developed at some length by Sir Otto Niemeyer. As he pointed out (Q. 8809), there is a " general sort of rough correspondence " between the present Sinking Fund of £50,000,000 and the revenue from the death duties. We agree with him, however, in not thinking " that it at all follows that the amount you ought to be providing for Sinking Fund, on the general consideration of your financial position, is necessarily the same as the amount you happen to be getting from death duties, even on the assumption that death duties come completely out of capital " (Q. 8806).

544. We have expressed the opinion that the Estate Duty is to a certain extent more damaging than income taxation to the supply of new capital. Some of our witnesses held that it does far more harm in this respect. We think it proper to make this effect on capital a ground for scrutinising State expenditure, and requiring that a due proportion of it should be devoted to capital and productive purposes. But we do not think it can justify any special allocation of revenue. A special allocation of the death duties would seem to endorse the mistaken notion that taxes on income do not materially affect the capital of the country.

IX. *Summary of Main Conclusions.*

545. We may very briefly sum up our main conclusions in regard to the effects of the death duties. In the lower ranges of capital value the Estate Duty is comparatively light, and it is only in estates upwards of £50,000 that the burden becomes markedly severe. In the largest estates, although not so crushing as is sometimes represented, it is very heavy, and leads, we believe, to considerable avoidance.

546. Owing to the fact that the Estate Duty is levied on estates in transit, its weight is, on the whole, less acutely realised than correspondingly heavy taxation of income. For the same reason, several incidental inequities are less damaging to the duty than they would otherwise be. Although the duty, when regarded separately, is less equitable than the Income Tax, it forms a valuable supplement to it, capital and income together furnishing a better criterion of ability to pay than either could in isolation.

547. Special inconvenience and hardships are sometimes caused to agricultural landowners and also to private businesses, and in a minority of cases the damage done may be considerable. At the same time, with regard to businesses, it is probable that the duty, amount for amount, is rather less of a deterrent to enterprise than the Income Tax. As regards the effect on

savings, we think that the Estate Duty, taking physical and psychological effects together, is distinctly more prejudicial, amount for amount, than the Income Tax; this is due partly to the nature of Estate Duty as a deferred tax, and partly to the fact that the bulk of the duty is drawn from the largest estates. Public companies, as well as private, are concerned here, so far as their supply of capital from the public may be affected. But, whatever the effect of the Estate Duty, it is fallacious to distinguish it from the Income Tax, as coming out of the nation's capital. Although the duty comes out of the capital of individual estates, it is provided out of the national income no less than the Income Tax; both forms of tax alike prevent a certain amount of new capital from coming into being, the ultimate effect depending very largely on the direction of Government expenditure.

548. The Legacy and Succession Duties are minor imposts. While their form is open to some criticism, they appear to us to be based on a sound principle, in that they go some way to differentiate the total death duties burden according to consanguinity.

SUB-SECTION VII: INCIDENCE AND EFFECTS OF THE STAMP DUTIES.

Introductory.

549. The Commissioners of Inland Revenue remark in their 65th Annual Report that the Stamp Duties are the oldest duties under their management. "They were first imposed in 1694 by the Statute 5 William and Mary, c. 21, the scheme of which was, broadly, that the documents to be charged were to be written on stamped paper, and the sanction relied on for the protection of the Revenue was the fact that documents could not be given in evidence in any Court unless they were properly stamped. Modifications have been made from time to time to meet changing conditions, and new heads of charge have been added, but the main outlines of the scheme of duties remain to-day as they were in 1694." (Cmd. 1780, page 54.) In 1818, after the Napoleonic Wars, the Stamp Duties (exclusive of Probate and Legacy Duties, which were commonly included under this heading) yielded about £5½ millions, or about 10 per cent. of the total tax revenue. In 1913-14 they yielded just under £10 millions, or about 6 per cent. of the total revenue. There was no change in the rates of duty between the outbreak of the late War and the 1st September, 1918; the yield fell during the War, the lowest figure being, approximately, £6¾ millions in 1915-16; in 1917-18 it had advanced to £8½ millions, but this figure represented only 1½ per cent. of the then expanded total yield of taxation. After the Armistice the duties became much more productive, answering to the boom in trade; as from September, 1920, the rates of certain leading duties were largely increased. In 1925-26 the duties yielded a

little over £25 millions (Great Britain only) which was about 3½ per cent. of the total tax revenue.

550. The Stamp Duties in Northern and Southern Ireland were, respectively, transferred to the Government of Northern Ireland from the 22nd November, 1921, and to the Provisional Government of Southern Ireland (now the Government of the Irish Free State) from the 1st April, 1922. For comparative purposes the total net receipts for Great Britain only may be set out for the post-war years and the last pre-war year :—

	£		£
1913-14... ...	9,647,180	1922-23... ...	21,851,257
1918-19... ...	11,837,512	1923-24... ...	21,578,756
1919-20... ...	22,088,542	1924-25... ...	22,758,159
1920-21... ...	25,630,558	1925-26... ...	25,129,369
1921-22... ...	18,991,002		

551. It will be seen that the Stamp Duties now form a rather subsidiary part of the tax system, although in the aggregate they provide a useful yield. While on the whole their effects were not greatly emphasised by witnesses, several of the duties were subjected to criticism, and there were no suggestions that this branch of revenue should be further developed. Professor Cannan, alluding to the duties on transference of property, characterised such taxes as " a survival from a bygone age in which the art of collecting taxes was so little developed that the stamp method seemed very excellent " (*E. in C.*, 19). It may be said of the duties generally, that they are not an advanced type of taxation. Their incidence is not clear, they have not only a casual relation to ability to pay, and they tend somewhat to hamper business transactions. On the other hand, they are quite well accepted by the taxpayer, partly, no doubt, because they have been established so long. Criticisms are mainly directed to the recent increases of duty, in 1918 and 1920.

552. We propose to confine our attention to the most productive of the numerous duties, in the following order :—

(i) duty on conveyance of land and property other than stocks and shares;

(ii) duty on transfer of stocks and shares;

(iii) duty on bearer bonds;

(iv) duty on companies' share capital;

(v) duty on cheques;

(vi) duty on receipts.

Several intricate questions arise as to incidence, but for practical purposes, and in view of the minor importance of the several duties in the total tax-system, these need not be discussed in detail.

(i) *The duty on conveyance of land, etc.*

553. *Rate of duty and yield.*—This duty was increased from 10*s.* per cent. to £1 per cent. in 1910. The net receipt (Great Britain) amounted to £1,423,932 in 1913-14; it fell considerably during the War, reaching a low-water mark of £814,560 in 1916-17. The net receipt (Great Britain) for post-War years has been as follows :—

	£		£
1918-19... ...	2,064,568	1922-23... ...	3,457,511
1919-20... ...	4,950,382	1923-24... ...	3,437,669
1920-21... ...	5,842,495	1924-25... ...	3,838,955
1921-22... ...	3,479,020	1925-26... ...	3,887,054

554. *Incidence.*—The incidence of the duty is rather indeterminate as between vendor and purchaser. When a tax is imposed on the conveyance of land, the prospect of recurrent liability on any occasion of sale tends to depress values, if only to a slight extent, and, in so far as it has this result, it falls upon all existing owners of land. When the first sale of a property takes place, the purchaser, although paying the duty on that particular transfer, will give a lower price for the property; if the lower price has taken full account of the recurrent liability, the incidence of the duty may be said to have been thrown back on the original owner, and to be avoided altogether by his successor. In practice, however, this theory works very uncertainly, owing especially to the uncertain frequency of sale. All that can be said is that the original owner may tend to suffer most; in land and house property, however, the exact price is so largely fixed by individual powers of bargaining that it is impossible to determine how far it has been affected by the duty or, in other words, what proportion of the duty has really been borne by either party.

555. *Criticisms by witnesses.* — Professor Cannan took the point that " everything which makes it more expensive to transfer property must tend to keep it in the hands of people who ought really to get rid of it, because they cannot manage it as well as somebody else." He thought the existing duties quite high enough to be appreciably hurtful in this way (Q. 814). We do not ourselves attach importance to this aspect. The duty is not, of course, the main item in the cost of transfer, especially when difficulties as to title, etc., are involved.

556. The Law Society called attention to the joint effect of the conveyance duty and the companies' capital duty on new or reconstituted businesses; the National Gas Council put in a statement in the same sense, with special reference to amalgamations (*Ev. Appendix* V). The conveyance duty, undoubtedly, adds very appreciably to the expenses of company formation, where large existing assets are taken over. We consider the combined burden under the head of the companies' capital duty (*cf. para.* 568).

557. The Law Society referred to an administrative concession, under which the duty is not claimed where a reconstructed company is being formed to take over the business of the existing company, and where the shareholders in the new company are the same, and hold shares in the same proportion, as those in the existing company. They advocated legislation extending not only to such reconstructions but also to the case where a private business is converted into a private limited company, and where substantially all the shares are taken up by the vendor or his nominees (*E. in C.*, 10-11). The latter type of case, however, does not appear to be on quite the same footing as the former. The conversion of a partnership into a company involves a more radical change of constitution, and, moreover, it offers considerable advantages in the matter of taxation, especially on account of the freedom of reserves from Super-tax. It is doubtful whether firms should be given a further inducement to conversion.

(ii) *The duty on transfer of stocks and shares.*

558. *Rate of duty and yield.*—This duty remained at 10*s.* per cent. until it was doubled by the Finance Act, 1920, the higher rate taking effect from the 1st September, 1920.

The net receipt (Great Britain), covering composition for transfer duty from corporations, &c., was £1,514,308 in 1913-14. In the early part of the War it fell heavily, reflecting the interference with normal Stock Exchange business, and in 1915-16 only amounted to £815,146. It then recovered and regained the pre-war nominal level in 1917-18. The net receipt (Great Britain) for post-war years has been :—

	£		£
1918-19 ...	2,169,952	1922-23 ...	5,349,354
1919-20 ...	4,991,893	1923-24 ...	5,014,438
1920-21 ...	3,648,777	1924-25 ...	5,494,748
1921-22 ...	3,211,377	1925-26 ...	6,789,749

559. *Incidence.*—£1 per cent. is rather more severe in the case of stocks and shares than in the case of land, since they constitute a much more mobile form of capital : against this may perhaps be set the fact that the other costs of transfer are much less. The question of incidence is difficult and obscure. A duty of this kind, in so far as it hampers dealings, may tend to have some depressing influence on the initial prices of stocks. The real losers, as Professor Seligman* points out, may be those responsible for floating the securities, or those underwriting the issue.

560. *Criticisms by witnesses.*—Sir Felix Schuster represented that the duty does not only reduce Stock Exchange transactions but also " obstructs the investment in the class of securities subject to the tax " (*Ev., p.* 11 : *E. in C.*, 13). We think the duty is open to some objection on both counts. It may tend

* *The Shifting and Incidence of Taxation*, 4th Edition, pp. 384–5.

to give a slight advantage to Government securities which are exempt from the duty, and to municipal stocks which only pay composition for the duty, the burden of this falling on the rate-payer; it may thus add a slight incentive to the tendency to favour gilt-edged stocks rather than ordinary industrial shares.

561. The Association of British Chambers of Commerce stated that " Stamp Duties on the sale of securities through the Stock Exchange are not only detrimental to business, but are considered unfair as compared with Stamp Duties levied on the transfer of other property " (*Ev., p.* 291; *E. in C.*, 68). We assume this criticism to have in view the point which we mentioned above, viz., that securities change hands more frequently than land and material assets, and therefore suffer rather more from a duty charged at the same rate.

(iii) *The duty on bearer bonds.*

562. *Rate of duty and yield.*—Except for Colonial Government and Colonial Municipality issues, the duty stands at £2 per cent., having been increased from £1 per cent. as from the 1st September, 1920. The rates for Colonial Government and Municipality issues are 5*s.* per cent. and £1 per cent. respectively.

The net receipt (Great Britain) was £1,034,099 in 1913-14. During the War the issue of foreign bonds almost came to a standstill. In 1914-15 the net receipt was under £½ million; in 1917-18 it had fallen to £167,326 and in 1918-19 to £103,542, but in the next few years it recovered, as the following figures show :—

	£		£
1918-19 ...	103,542	1922-23 ...	1,253,651
1919-20 ...	459,168	1923-24 ...	1,162,484
1920-21 ...	602,664	1924-25 ...	970,643
1921-22 ...	735,966	1925-26 ...	831,688

563. *Incidence.*—Apart from War Loan issues, bearer bonds are exceptional in British finance, while they are a common feature in many countries. The incidence of the duty which, in broad idea, is a composition for the transfer duty applicable to registered stocks, appears normally to be on the borrower; for the foreign borrower has to offer terms as acceptable to the lender, all things considered, as the home market will provide, and the lender will not be ready to take the burden of the duty on himself.

564. *Criticisms by witnesses.*—Several witnesses referred to the competition between this country and the United States for foreign loan business. " The United States," said Sir Fredric Wise, " has a distinct advantage over Britain in regard to Stamp Duties, and therefore the foreign loan competition, although keen, enables the United States in some instances

to pick and choose her foreign flotations " (*E. in C., Ans.* 13). Mr. Beaumont Pease, Sir Felix Schuster and Mr. A. M. Samuel dealt with the same point, emphasis being laid upon the value of foreign loans floated in this country as stimulating our export industry. " I do not think," said Sir Felix Schuster, " it is sufficiently appreciated that the issue of foreign loans both for Government and industrial enterprises is directly productive of trade and employment in this country, and not only sporadically, but that their effect is permanent (*Ev., p.* 11; *E. in C.*, 13, *cf. also* Q. 114).

At the same time, while Sir Felix was convinced that in the long run the £2 duty must have the effect of turning business away, he had not been able to find any direct evidence that so far this had actually taken place. " I tried to find out from some of the houses concerned in that class of business whether in their experience it has had that effect. They said : ' No, not so far, because so far this business comes to the United States or here, and there is no other lending country ' " (Q. 114). Mr. Samuel, again, remarked that " whether harm arises in present circumstances from the loss of such business is doubtful. Some of the foreign loans alleged to have been driven away from London by high Stamp Duties were floated in New York. But it is said that New York failed to digest the loans, and that London bought the loans in New York, and brought them to London, at a cheaper rate than that at which they would have been issued in London " (*E. in C. Ans.* 13).

565. The figures of yield for post-war years, although they do not prove anything, give no ground for inferring that the growth of foreign loan issues in this country has been checked by the £2 per cent. duty. Apart from questions of comparative taxation, the United States have in the past looked with less favour than ourselves on foreign issues, and it appears that they tend to demand a higher rate of interest. It may well be that the advantage enjoyed by the British market in this respect is more than enough to cancel any deterrent effect of the duty, at least in the case of loans to foreign industry. The matter, however, requires to be carefully watched : it would be unjustifiable to continue the duty at its present level, if it appeared to have a material influence in diverting foreign loan business.

It should be noted that, while the duty is borne by the foreigner, it can hardly be said to differentiate against him, for £2 per cent. is only equivalent to the transfer duty on two transfers of British registered stocks. If the duty on bearer bonds were reduced it would probably be necessary to reduce also the more productive transfer duty; the two can hardly be considered separately, and indeed a reduction of the transfer duty might occasion some demand for a similar reduction of the £1 per cent. conveyance duty relating to property other than stocks and shares.

(iv) *The duty on companies' share capital.*

566. *Rate of duty and yield.*—The duty on companies' share capital was increased from 5*s.* per cent. to £1 per cent. by the Finance Act, 1920, with effect from the 20th April, 1920.

The net receipt (Great Britain) was £697,517 in 1913-14: the lowest point to which it fell during the War was £210,605 in 1916-17. Immediately after the Armistice there was an unprecedented boom in company flotations, reflected in the following figures:—

	£	
1918-19	1,024,961	5*s.* per cent. still in force.
1919-20	3,645,088	
1920-21	5,853,121	£1 per cent. in force from 20th April, 1920.
1921-22	2,141,451	
1922-23	1,855,497	
1923-24	2,294,725	
1924-25	2,225,102	
1925-26	2,680,004	

567. *Incidence.*—The companies' capital duty tends to fall on the company, and not to be passed on in prices to the consumer. Ultimately, the effect is upon the shareholders, since the duty is a charge against the profits of the concern. (In the case of the private company, of course, the distinction between company and shareholder hardly exists for this purpose.)

568. *Criticisms by witnesses.*—The Association of British Chambers of Commerce (*Ev.*, *p.* 291; *E. in C.*, 69-70) and the Law Society (*E. in C.*, 3 *and* 8) both expressed the opinion that the companies' capital duty is harmful in reducing the number of company registrations, and also the amount of capital for which registration is sought. Sir Felix Schuster, while considering the duty rather too high, did not think it had actually interfered very largely with the formation of new companies (Q. 114). The Law Society recognised that the number of companies formed in recent years was large and showed no sign of diminution, but contended that, "were it not for this heavy impost, the number of registrations would undoubtedly be larger" (*E. in C.*, 3); the Society had in mind the conveyance duty (*cf. para.* 556) as well as the companies' capital duty. The registrations of companies (England only) in 1913 and in post-war years are recorded as follows in the Board of Trade Reports on Companies:—

	Registrations (in England only).	
	Numbers.	*Average amount of capital.* £
1913	6,871	21,358
1919	9,820	39,117
1920	10,087	55,447
1921	6,402	15,481
1922	7,993	15,138
1923	8,008	13,368
1924	7,974	13,613

569. When the numbers of registrations are seen, and when it is remembered that the companies' capital duty (even though in combination with the conveyance duty) is not the only expense of company formation which has increased, it appears to be doubtful whether registration has been materially restricted by the duty. The creation of new companies is influenced by very wide causes, as we remarked in discussing how far the Income Tax had a bearing upon it (*para.* 404). The capital duty and conveyance duty must not infrequently have turned the scale against amalgamations and reconstructions, but we hardly think it likely that they have seriously interfered with the creation of new companies, or that, as the Law Society suggest (*E. in C.*, 9), they have deterred many foreigners from forming companies here and also driven Englishmen to register abroad, instead of here, companies formed to carry on business abroad; besides, in many foreign countries similar duties are in force. Although we do not regard the companies' capital duty as a good type of tax, it is arguable that the benefits of incorporation are such that companies can afford to pay something for them, and that the existing duty, paid once and for all, is not very excessive, especially since the Corporation Profits Tax has been repealed.

570. With regard to the average amount of capital registered, it would be very mistaken to attribute the whole of the diminution to the effect of the Stamp Duties. In the first place, allowance must be made for the fall in the price level. Then again in 1919 and 1920 large nominal amounts of capital were registered, because a sanguine view was taken of trade prospects and it was thought that a great deal of capital would be required. There can be no doubt that in later years the difference between the capital registered and the capital actually issued to the public has been narrower, but it is not clear that the tendency to put the capital lower does any great harm, although it may occasionally have the result, pointed out by Mr. Randle Holme, one of the Law Society's representatives, of hampering private businesses in raising new capital and somewhat prejudicing their credit. (Q. 7651.)

(v) *The duty on cheques.*

571. *Rate of duty and yield.*—The duty on cheques was raised from 1*d.* to 2*d.* by the Finance Act, 1918, with effect from September, 1918. The net receipt and the approximate number of cheques used (Great Britain) have been as follows, from 1913-14 onwards :—

	£	*Millions of Cheques.*
1909-10	1,030,656	247
1910-11	1,110,563	266
1911-12	1,121,652	269
1912-13	1,148,880	276
1913-14	1,225,200	294
1914-15	1,169,500	281

	£	*Millions of Cheques.*
1915-16	1,205,500	289
1916-17	1,243,500	298
1917-18	1,274,000	306
1918-19	2,891,000	303
1919-20	2,890,400	345
1920-21	3,313,300	397
1921-22	2,724,700	327
1922-23	2,850,000	342
1923-24	3,025,000	363
1924-25	3,222,000	387
1925-26	3,421,684	411

572. *Incidence.*—The duty falls on the person drawing the cheque, and is borne by him, unless he can pass it on in some business transaction. The trader may generally be assumed to pass the duty on to the consumer, since it enters into the costs of all traders, including the marginal man.

573. *Criticisms by witnesses.*—It was contended by several witnesses that the restoration of the 1*d.* duty would very substantially increase the use of cheques. Mr. Beaumont Pease, however, could not find that the 2*d.* duty had diminished their use (*E. in C.*, 23). Sir Felix Schuster thought that, with the duty at 1*d.*, cheques would be used more freely for payment of wages, and that more banking accounts would be opened. (Q. 114.) Mr. Samuel thought that small shopkeepers would take to the use of cheques, if the duty were only 1*d.* (Q. 1007), and the National Chamber of Trade—a federation of local bodies consisting mainly of distributing traders, and the smaller craft traders—represented that " maintenance of the war increase of 2*d.* for such a long period after the conclusion of the War has created a very definite sense of grievance besides leading many to avoid payment by cheque whenever it can be done (*E. in C.*, 13). The Drapers' Chamber of Trade of the United Kingdom suggested that " a reversion to 1*d.* cheque stamps would probably mean the quicker payment of small debts which in the aggregate throughout the country would mean greater and quicker turnover of capital " (*Ev.*, *Appendix* II, *para.* 5).

574. We think that the effect of the 2*d.* stamp is a good deal exaggerated, although we have no doubt that a reduction to 1*d.* would do something to encourage the freer use of cheques and banking facilities. It is sometimes argued that the 2*d.* stamp tends to make people draw cheques for larger sums than they did before the duty was increased, but, quite apart from the duty, they might be expected to draw larger cheques simply on account of having to pay higher prices for almost everything. We think that this natural tendency exists—possibly aided to some slight extent by the 2*d.* duty. So far as it is true that larger cheques are drawn on account of higher prices, the fixed 2*d.* duty cannot be said to represent twice as heavy a charge as the pre-war 1*d.*

It does not seem, then, that the 2*d.* stamp should be much more discouraging to the use of cheques than the 1*d.* stamp used to be. From the numbers of cheques (*para.* 571) it will be seen that in pre-war days there was an annual increase of about 5 per cent. There was a slight decrease in the year following the raising of the duty (possibly due to reduced stocks being kept by the banks) but in the next two years of boom nearly 15 per cent. was added each year. The slump in 1921 brought the number down to a more normal level and an increase of roughly 5 per cent. has taken place from 1922-23 onwards.

575. Considerable stress was laid by Sir Felix Schuster (*Ev., p.* 11; *E. in C.*, 13), Mr. Samuel (*E. in C., Ans.* 13), and the Chambers of Commerce (*Ev., p.* 291; *E. in C.*, 71-2) on the prospect of reducing the currency note circulation, if the duty were halved or abolished. We cannot believe, however, that such a step would have any considerable bearing on the monetary position, even if the result were a marked increase in the use of cheques; it is the total volume of currency in circulation, rather than the amount of cheques or notes comprised, which is of real importance.

(vi) *Duty on receipts.*

576. *Rate of duty and yield.*—The receipt duty, applicable to receipts for £2 and upwards, was raised from 1*d.* to 2*d.* by the Finance Act, 1920, with effect from September, 1920. The yield of the tax cannot be exactly distinguished from figures of postal revenue, since in most cases the ordinary postage stamp is used for receipts. In recent years it has been in the neighbourhood of £2 millions : it does not appear that the doubling of the duty has effected the giving of stamped receipts.

577. *Incidence.*—The incidence tends to be on the consumer, but cannot be allocated with certainty.

578. *Criiicisms by witnesses.*—Very little mention was made of the 2*d.* receipt duty. The National Chamber of Trade linked it with the 2*d.* cheque duty as engendering a sense of grievance (*E. in C.*, 13) and the Association of British Chambers of Commerce held that both alike should be reduced to the pre-war rates (*Ev., p.* 291; *E. in C.*, 72). There is little to be said in favour of a duty on receipts except that where, as in this country, people have grown accustomed to it, it is an easy enough method of raising a not altogether negligible revenue. Its great defect is that it can be very simply avoided by not giving a receipt. It may be of interest to mention that from 1783 to 1853, when Mr. Gladstone introduced the fixed 1*d.* duty, there was a graduated duty. From 1815 to 1853 the scale rose to as high a maximum as 10*s.* on receipts of £1,000 or more The repeal of the graduation in 1853 resulted in a larger yield. As Mr. Gladstone said, it was a duty entailing very considerable inconvenience and had been evaded wholesale.

General Conclusion.

579. The Stamp Duties are a cause of occasional irritation to the citizen, and of some recurrent friction in business, and particularly in finance. While they are open to many objections, they do not seem in practice to meet with much opposition from the general taxpayer, and they may be held to illustrate the saying that an old tax is a good tax. Nevertheless, in relation to their moderate yield, we are disposed to think them one of the less satisfactory parts of the British tax system.

SUB-SECTION VIII: THE CUSTOMS AND EXCISE DUTIES.

The Incidence of the Duties and their more Immediate Effect on Prices.

580. In regard to the existing Customs and Excise duties, the question of incidence, in the sense in which we use the term (*cf. para.* 288 *et seq.*) is not controversial, as it is in the case of the Income Tax. There was general agreement among witnesses that, broadly, the duties are passed on in price to the consumer.

581. It is, however, a debatable question how far the duties are a clean addition to price. The actual movement of prices is not a complete test: prices are open to all the varied forces of supply and demand, and, particularly in the case of imports, the market is sensitive to changes in world conditions. It follows that the exact effect of a change in a rate of duty may quickly become obscured.

582. Even the movement immediately after an increase or decrease of duty cannot be entirely relied upon: for in the case of many dutiable goods the article sold retail is a blend, the components of which may often easily be altered to at least a slight extent. When, therefore, the price of a dutiable article rises or falls exactly in accordance with a change in the duty, it cannot in all cases be said with absolute confidence that the two changes are exactly equivalent.

583. We may glance briefly at some considerations which may affect the addition to price, when a duty is substantially increased. Let us take the case of a commodity manufactured in this country. The increase in duty, when added to prices, will normally cause demand to slacken to some extent, and supply will be adjusted accordingly. In the case of diminishing returns, a reduction of supply should tend to bring about some fall in the cost per unit of production, and then—in theory—less than the full tax ought to be put on to the price: under increasing returns, where the cost per unit is increased by a reduction of supply, more than the tax might be put on. Professor Pigou, who referred to this aspect of the subject, did not think it possible to measure the variations in unit cost. He

assented that, in the absence of knowledge, it seems best to assume that there is no great variation : then to all intents and purposes it is possible to say, so far as this argument is concerned, that the tax raises the price by the amount of the tax (Q. 600-610).

584. Again, it was stated by the Association of British Chambers of Commerce and by the Co-operative Congress that prices are often increased by more than the indirect tax in order that the trader may cover interest on the further capital expended. This is no doubt so, although the interest is likely to be relatively a very small factor.

585. It may further be contended that an actual profit is made on the tax, and the support of Adam Smith can be quoted : " A tax upon these articles (necessaries of life) necessarily raises the price somewhat higher than the amount of the tax, because the dealer who advances the tax must generally get it back with a profit." But Professor Seligman, referring to this view and dealing with a commodity which passes through several hands, points out that " under competitive conditions, there is always a producer or middleman on the margin of production—that is, one who produces or handles the product without profits, simply getting back his expenses—and the price of the whole supply, at any given moment, is equal to his cost of doing the business. . . . The mere fact that the product passes through a number of hands cannot in itself raise the price by more than the exact cost of such transference. . . . The tax is simply an addition to the cost of production; and there can be no geometrical increase in the tax."* This argument is, we, think, valid, assuming free competition over the whole field of supply. In actual fact, where competition is not in free play, it may well be that some profit is made on the tax. This, we think, will be particularly so at the retail stage, owing to the personal and local advantage often enjoyed by the retailer.

586. On the whole it is likely that in most cases the amount directly passed on to the consumer on account of Customs and Excise duties corresponds fairly closely with the amount of those duties, but with a natural tendency to be rather greater.

587. In the general note on " incidence " (*paras.* 288-92) it has been observed that a trader who succeeds in shifting a tax may nevertheless suffer from reduced sales, and again, that an employee who bears a tax may be able on that account to obtain an increase of wages.

588. The above paragraphs relate only to the existing duties. We are not called upon to discuss the incidence of commodity taxes in general. However, in order to avoid any misunderstanding it may be well to note that we are not attempting to lay down a hard and fast rule that all such taxes in their

* *Incidence of Taxation*—Columbia University Press—4th Edition, 1921—p. 353.

entirety are necessarily borne by the consumer. Economists are generally agreed that there are conditions in which an import duty may be partly borne by the foreigner, e.g., if there is only a limited market for his particular commodity outside the country where the duty is in force: in such a case, rather than lose an important part of his market, he may choose to bear some of the duty.

General Effects of the Customs and Excise Duties.

Introductory.

589. The Customs and Excise duties may be contrasted with the Income Tax, as indirect taxes, which are intended to be, and in fact are, passed on to the consumer. Again, they may be contrasted as taxes which apply to a limited field,—viz., to certain selected commodities—while the Income Tax is a general tax applying to income as such.

590. A common objection to the taxation of commodities is that it interferes in an artificial way with the natural course of expenditure, and so of production. People may buy less of the taxed goods, and the trade which supplies them may be expected to suffer. The strength of this particular criticism depends very much on the goods chosen for taxation. The existing Customs and Excise duties are mostly levied on articles of very general consumption, the demand for which is relatively inelastic. On the whole, to judge by the effects of changes in their rates, the duties do not appear to have altered the character of consumption very greatly, except in the case of alcoholic drinks. The heavy taxes on beer and spirits have undoubtedly had an important restrictive effect*; here, however, it does not follow that the result has been harmful either to the consumer or to national production as a whole, while the brewers and distillers—apart from inefficient concerns—do not appear to have been in a worse position than before.

591. We do not think that the existing duties have had any very disturbing effect on the trade of the country. At the same time we are of opinion that the tendency of indirect taxation is, in general, to cause not only dislocation when first imposed or varied, but a continuing diversion of trade from the course it would otherwise pursue: the present system is comparatively harmless in this respect only on account of the particular subjects on which the bulk of the duty is levied.

592. Practically, the chief questions to be considered arise from the weight of the burden which the duties lay upon the poorest members of the community: we propose then to examine the effect of the duties on the standard of living and physical efficiency of the wage-earning classes.

* The change in consumption, however, must not be entirely attributed to this cause. It is partly due, no doubt, to enforced war-time restrictions which were in operation long enough to affect habits; it is also partly due to the trade depression and other general causes.

The order of our discussion will be as follows :—

	Paragraphs.
I. The weight of the duties and the standard of living—	
General	593-4
Regression in the indirect taxes...	595-7
Indirect taxes and wages ...	598-614
" Necessaries " and " luxuries "	615
The duties on tea, &c.	616-24
The duties on sugar, &c.	625-31
The duty on tobacco	632-7
The duty on spirits...	638-42
The duty on beer	643-49
The duty on wine	650-4
The Entertainments Duty... ...	655-8
Conclusions	659-67
II. The effect of the duties on saving ...	668-70

I.—The Weight of the Duties and the Standard of Living.

593. *General.*—From the table in paragraph 218 it will be seen that the great bulk of the yield is from the food, alcohol, tobacco and entertainments duties. The following table will illustrate the weight of these duties in 1913-14 and in the last three years :—

	Total net receipts of duty.				Duty per head of population.							
	United Kingdom.	Great Britain and Northern Ireland.			United Kingdom.	Great Britain and Northern Ireland.						
	1913/14.	1923/24.	1924/25.	1925/26.	1913/14.	1923/24.		1924/25.		1925/26.		
	£000.	£000.	£000.	£000.	s. d.	£ s. d.		£ s. d.		£ s. d.		
Tea ...	6,499	10,731	5,971	5,780	2 10	0 4	9¾	0 2	8	0 2	7	
Sugar ...	3,329	38,117	20,532	19,370*	1 5½	0 17	1	0 9	3	0 8	6	
Other Foods	1,078	2,680	1,650	1,549	0 5½	0 1	2¾	0 0	7½	0 0	9	
Beer ...	13,655	81,702	81,987	82,403	5 11½	1 16	7½	1 16	6	1 16	7	
Spirits ...	23,976	54,037	51,054	49,928	10 6	1 4	3	1 2	9	1 2	2	
Wine ...	1.152	3,369	3,752	3,746	0 6	0 1	6	0 1	8½	0 1	8	
Tobacco ...	18,284	51,882	51,913	53,498	8 0	1 3	3	1 3	1½	1 3	9	
Entertainments.	—	9,285	6,249	5,714	—	0 4	2	0 2	9½	0 2	6	

* Includes arrears of duty £232,400 from 1924–25.

594. An attempt has been made in the tables in paragraph 255 to illustrate the burden of the duties at certain points on the income scale. The figures present a very different appearance from those of the progressive direct taxes. Instead of increasing from a very low charge on the small income to a very high charge at the top of the income scale, they advance very little and soon reach a maximum. In other words, the indirect taxes

are regressive; the smaller the income, the larger is the rate upon it which the taxes represent.

595. *Regression in the indirect taxes.*—When we speak of a tax as regressive we have in mind simply the ratio of the tax to incomes of different sizes. If everybody's expenditure on a given taxed article were the same, whatever their income, the rate of tax borne by the individual would vary inversely to the size of his income, e.g., if the tax were ¼*d.* in the pound for an income of £1,000, it would be ½*d.* in the pound for an income of £500, 1*d.* in the pound for an income of £250, and 2½*d.* in the pound for an income of £100. Where a light tax is laid upon a cheap article of general consumption, the regression approximates to this type all through the income scale. But the heavier the tax the more it will tend to restrict consumption in the smaller incomes as compared with the larger; as a result, the tax will be less regressive at the lower end of the income scale.

596. For the sake of example, we may take an imaginary case: the increase of a duty from 0·2*d.* per unit to 5·2*d.* per unit might have an effect of the following kind:—

—	Income.	Units bought.	Price per unit.	Expenditure.	Tax.	Rate pence per £.
				£ s. d.	£ s. d.	
Tax 0·2*d.* per unit.	100	50	4*d.* (including 0·2*d.* tax)	0 16 8	0 0 10	·1
	200	55	,,	0 18 4	0 0 11	·055
	500	57	,,	0 19 0	0 0 11·4	·023
Tax 5.2*d.* per unit	100	30	9*d.* (including 5·2*d.* tax)	1 2 6	0 13 0	1·56
	200	45	,,	1 13 9	0 19 6	1·17
	500	55	,,	2 1 3	1 3 10	·57

In this example the raising of the duty has led to a severe curtailment of consumption, especially for the £100 income. The higher tax is less regressive, but it may be very damaging if the subject of the tax is a valuable article of diet.

597. It is therefore necessary to judge an indirect tax not only according to the degree of its regression, but also according to its actual weight, and the extent to which it affects consumption.

But, before we proceed to consider the principal existing duties on this plan, we must examine the important and rather difficult question of the relation between those duties and wages. It is sometimes urged that the working classes have been largely compensated for the increased duties by extra wages granted on their account. This goes to the root of the question how the duties are really affecting the standard of living.

598. *Indirect taxes and wages.* (i) *General.*—In the section of our Report dealing with the standard of living (*paras.* 9 to 44) we have seen that, compared with 1914, weekly rates of money wages have, on the average, advanced to about the same extent as the cost of living. But this average correspondence conceals the greatest diversity in different industries. In some of the sheltered trades wage-rates have moved right ahead of the cost of living, while in some of the depressed export trades they have fallen far behind. Generally, we noted that the unskilled have gained to some extent as compared with the skilled.

599. Whether an individual wage-earner has the same purchasing power as before the war depends on the extent to which the wage-rates, etc., affecting him have advanced, and the way in which he is in the habit of laying out his money. For instance, the teetotaler, other things being equal, has more easily retained his power to purchase the same quantity of the same commodities than the beer-drinker, beer having gone up in price more than the general cost of living.

600. In some cases it may happen, without the application of any index figure, that wages in a given post have advanced sufficiently over the pre-war amount to cover the increase in the individual's cost of living, including all the dutiable articles on which he has been in the habit of spending.

601. The question with which we are concerned in such a case is the *reason* for the increase in wage-rates. Is it on account of the increased duties that the individual has succeeded in obtaining an increase of wage sufficient to cover them? If so, he has escaped the whole effect of the increased taxation; otherwise he has not. Clearly the reason cannot be assumed. The fact that his wages have advanced sufficiently to cover the increased duties may be a mere coincidence.

602. Let it be supposed that the extra duty he bears on tea, sugar, tobacco, &c., amounts in all to £10, and that his increase of wage amounts in the year to £80. The increase in the wage-rate will have been regulated by a variety of factors in addition to the increase in the cost of living; primary factors will have been the amount which the industry could afford, and the relative bargaining strength of employers and men. We have to ask what part of the £80 can really be attributed to a particular element—indirect taxation—in a particular factor—the increased cost of living. It is impossible to say.

Suppose, for the sake of illustration, it is £3. Then the increase of Customs and Excise duties has imposed on the individual a burden of £10, and it has enabled him to obtain, as against this burden, £3 more in wages. It happens by mere chance that the increase in wages (£77) due to other causes has enabled him to meet the balance of £7 duty, without reducing his consumption or his saving in any direction.

603. (ii) *The cost of living index.*—It might be thought that the element of increased wage-rates due to indirect taxation could be analysed out in the case of wage-earners (now about 2½ millions out of some 16 millions) whose wages are regulated by the Ministry of Labour index; for tea, sugar, and to some extent, tobacco, are represented in the index. This, however, is only true to an exceedingly limited extent.

604. It may be desirable first to glance at the nature of a cost of living index. Such an index does not profess to include all the goods on which a wage-earner may be expected to spend his money. But, so far as the general elements of price are concerned, an index based on a reasonably wide and representative series of articles ought to give at any time a fairly accurate picture for the entire field; the cost of labour and the charge for profit are very important elements in the retail prices of all commodities, and in general they induce a relative consistency in price movements. On the other hand, indirect taxes on a few selected articles constitute a freak element in price. Thus an index will tend to be unrepresentative for taxed articles, if it excludes them; if it includes them, it will tend to be less representative for articles in general.

605. In the Ministry of Labour index, while tea, sugar, tobacco, and matches are included, other taxed articles, among them being alcoholic drinks, are excluded.

The current index number includes the following increases in respect of increased duties since 1914:—

Sugar	...	...	...	1·62 per cent.
Tobacco	...	...	...	0·40 ,,
Matches	...	...	...	0·16 ,,

There is a decrease of 0·36 per cent. in respect of the lower duty on tea.

606. The index is not representative for, e.g., the price of beer. The index averaged 175·6 in 1925; the price of beer, of the quality commonly sold, has increased through taxation and general causes from 2½d. per pint in 1913-14 to 6d. per pint, and even so the beer is weaker.

607. Where the index is in use, the basic wage-rate to which it is applied will normally be found to have been settled by negotiation at a figure differing, more or less, from that of 1914, or, in the case of a post-war basic wage, from that of 1914 varied by the extent of the variation in the index number. In the result, the increase in wage-rates over 1914 cannot be said to have been solely determined according to the cost of living index.

608. Further, even where the advance in the 1926 wage-rate over that of 1914 happens to have corresponded very closely with the rise of the index figure, it is not possible to say exactly or with certainty how much of the advance may be attributed to

the extra burden of Customs and Excise duties. It is necessary to pay regard to two factors—

(i) the motive force leading to increase of the wage-rate;
(ii) the measure supplied by the index figure.

(i) So far as the cost of living is concerned, the *general* cost is the motive force; it cannot be said that so much of the increased wage-rate was sought and obtained on account of the price of sugar, clothing, or any other single item in the index; nor can it be said how much influence the price of beer, or of any other item not in the index, may have had.

(ii) At the same time, the duties on tea, sugar, and tobacco are represented in the index, and the index has, in the event, closely determined the increase given on account of the general cost of living.

609. It appears, therefore, that so far as the index has come into play, the duties on tea, sugar and tobacco have had a special influence on the wage-rate; the duties on beer, &c., have had a more remote influence.

610. The position is more clear when the various contributing forces have once settled a basic wage-rate and agreed to the application of the index to future variations in the cost of living. Any future increase of the tea and sugar duties, provided it affects the price of tea and sugar sufficiently, will then automatically be met by a corresponding, though not necessarily equivalent, advance of wage-rates. Incidentally, the advance may at the same time increase the purchasing power over beer, entertainments, &c.

Again, if the duties on tea and sugar were abolished and their prices fell, there would be a corresponding, though not necessarily equivalent, decrease in wage-rates; this also would affect the purchasing power over items not in the index.

611. The movements in the index number which would result from changes in retail prices (due to any cause) are as follows:

Commodity.	Change in retail price.	Corresponding change in index number.
Tea	1*d.* per lb. ...	0·22
Sugar	1*d.* „ „ ...	1·65
Matches	1*d.* per 12 boxes...	0·05
Tobacco, as such	1*d.* per oz. ...	0·10
Cigarettes	1*d.* per 10* ...	0·13

* i.e., ten cheap cigarettes, such as were 10 for 3*d.*, pre-war.

612. (iii) *Conclusions.*—The general conclusion to be drawn is that wage-earners, as a whole, have obtained a certain indefinable increase in wage-rates on account of the extra post-war burden of Customs and Excise duties which they bear. In

wage negotiations the idea of the cost of living has been influential, the increased duties have been an element in the post-war cost, and the Ministry of Labour index, which reflects the increased duties on tea, sugar and to some extent tobacco, has been an important standard of reference.

613. It is, however, necessary to bear constantly in mind the different types of case (i) where wage-rates have easily outstripped the cost of living index and bear no particular relation to it, (ii) where they have advanced to a more or less similar extent, and have been partly determined according to the index, or at least have been influenced by it, and (iii) where they have fallen clearly behind the index, as is commonly the case in trades which supply a foreign market.

In case (iii) it is clear that the worker has got no compensation on account of his extra burden. In cases (i) and (ii) it is impossible to analyse out any sort of figure; but it seems possible that in case (ii) he may have got compensation equivalent to a fairly substantial part of the food duties, though only to a small part of the duties on beer, tobacco, etc., and that in case (i) he may have secured appreciably more than in case (ii), although everything depends on the ultimate reasons for which the increase of wage was sought and obtained.

It cannot be said that wage-earners as a whole have escaped any definite part—or, it seems, any very considerable part—of the extra burden laid upon them.

As regards those whose wage-rates are governed by the cost of living index we have noted that, from the time when the index is first applied and so long as it continues to be applied, changes in the cost of living due to variations in the tea, sugar and tobacco duties (but not in the duties on alcoholic liquors and entertainments) are accompanied by, though not necessarily balanced by, changes in the wage-rates.

614. In the foregoing paragraphs we have directed our attention to wage-rates and to the wage actually received by the employed wage-earner. The total sum paid as wages to the wage-earning class has to be carefully distinguished; it is dependent not only on wage-rates, but on the extent of unemployment, and these two, taken together, are largely determined by the total physical production of the country. It is held in some quarters that, without increased production, a successful attempt to give one section of workers higher real wages can only result in a reduction of real wages to others, or in increased unemployment. It is obvious that, if or so far as this is true, the influence of indirect taxes on wages as a whole is even more shadowy and indeterminate than their influence on wage-rates in this and that industry.

615. "*Necessaries*" *and* "*luxuries*."—The main Customs and Excise duties are usually regarded as falling into two classes according to the articles on which they are levied, tea and sugar being necessaries, while tobacco and alcoholic drinks are called

luxuries. The classification is justified, although the distinction is not absolute and we do not wish to draw it too sharply. It may even be possible to regard tea-drinking as a luxury. One of our witnesses was personally inclined to take this view, being " rather impressed by certain medical opinions that have been expressed that there is too much tea drunk and that it has harmful effects " (Q. 4885). Again, while, e.g., champagne and cigars may be classed as luxuries without reservation, it can reasonably be argued that, social customs being what they are, it is not fair to label as luxuries the beer and tobacco of the moderate consumer. In adopting the usual classification, we imply a difference in degree, on the scale lying between necessity and luxury, rather than a contrast.

616. *The duties on necessaries.* (i) *Tea, cocoa, coffee and chicory.*—These articles being to some extent alternatives, the rates of duty have, since 1916, been correlated in order that a given quantity of each beverage may bear approximately the same weight of taxation. Tables giving full particulars of consumption and duty, 1913-14 to 1925-26, are included in Appendix IX. Here we will deal principally with the duty on tea, the others being of lesser account.

617. Before the War, the tea duty stood at 5*d.* per lb., 1*d.* higher than the full rate now in force, which was fixed by the Finance Act, 1924. In 1914-15 the rate was 8*d.*, from 1915-16 to 1921-22 it was 1*s.*, and for 1922-23 and 1923-24 it was 8*d.* Since 1919, however, Empire-grown tea has paid the preferential rate of duty provided for in the Finance Act of that year, i.e., 5/6ths of the full rate. About 87 per cent. of the tea consumed is Empire-grown.

618. The average duty per lb. of tea, and the average retail price (so far as it can be ascertained*) with the consumption and duty per head of population, have been as follows in 1913-14 and in the post-war years :—

		Approximate Average Duty.	Approximate Average Retail Price.	Per Head of Population.	
				Consumption.	Duty.
		s. d.	*s. d.*	lb.	*s. d.*
United Kingdom	1913-14	5	1 6	6·8	2 10
	1918-19	1 0	2 8	Not available.	
	1919-20	10¼ (after Sept.).	2 8	Not available.	
	1920-21	10¼	2 9½	8·5	7* 3½
	1921-22	10¼	2 6½	8·8	7 5½
Great Britain and Northern Ireland.	1922-23	6¾	2 4½	8·6	5 0½
	1923-24	6¾	2 6½	8·5	4 9½
	1924-25	3½	2 4½	9·0	2 8
	1925-26	3½	2 5½	9·0	2 7

* Mainly from the Ministry of Labour Gazette.

619. The price of tea responds to world-wide influences, and a close correspondence between changes of duty and changes of price is not to be expected. In 1924-25 the reduction in price immediately after the Budget was partly cancelled later on. The Co-operative Congress pointed out that this was due to an increase in the world consumption of tea (Q. 4345). There was an increased demand from Russia and the United States. There was also, it may be added, a partial failure in the Indian crop.

620. Consumption of tea was on the increase in the early part of the war. It began to fall after the second increase in the duty (from 8*d.* to 1*s.* per lb. in September, 1915) and this fall was soon accelerated by increases in price due to other causes. The year 1917 saw partial prohibition of imports, and regulation of prices; in November the Ministry of Food took charge of supplies.

From July to December, 1918, tea was rationed, but from the Armistice onwards, and particularly from February, 1919 (with the removal of all restrictions), there was a free inflow of supplies and a marked rise in consumption.*

621. The recent figures of consumption per head are notably and consistently greater than before the War: as the mass of people are conservative in the direction of their expenditure, the new level of tea-drinking requires some explanation. It is no doubt partly due to the reduced consumption of spirits and beer (*cf. paras.* 639 *and* 648). Probably another reason of considerable force is that during the War men on service became used to tea as a drink, and formed a new habit.

Whatever partial explanations may be found, we think the increase may have some significance in pointing to an improvement in the standard of living (*cf. para.* 37).

622. It will be observed that in 1924-25 the per head consumption rose from 8·5 lbs. to 9 lbs. The Co-operative Congress informed us that for a period after the Budget of 1924, before prices rose again (*cf. para.* 619), they experienced a considerable expansion in the demand for tea: they supplied certain figures of wholesale sales (*Ev., p.* 306; *E. in C.* 25-27, and Q. 4349). It is reasonable to think that, with a lower price, the amount of tea consumed might be larger: it is, however, not possible to say how nearly the point of satisfaction has been approached.

623. The duty now in force, amounting to about 2*s.* 7*d.* per head is very light, although not negligible for the smallest incomes. Payment of something like 11*s.* or 12*s.* in the year (*see tables in para.* 255) is a consideration for a family income of £100 or £150.

624. The duties on cocoa, coffee and chicory call for little separate comment. That on cocoa (all cocoa goods) amounts now to about 4*d.* per head, and that on coffee and chicory to about 1¼*d.* per head. It is of interest to note that while the per

* For the history of the Customs and Excise revenue during the War reference may be made to the Eleventh Report of the Commissioners of Customs and Excise (Cmd. 1082), pp. 29-36

head consumption of coffee has altered very little, the quantities of raw cocoa which have paid duty have doubled since 1913-14. Over 90 per cent. of the cocoa is of Empire production and pays the preferential rate introduced by the Finance Act, 1919.

625. *The duties on necessaries.* (ii) *Sugar, &c.*—In addition to sugar (including sugar in composite articles imported), molasses, glucose and saccharin are included under this head. A table giving full particulars of consumption and duty, 1913-14 to 1925-26, will be found in Appendix IX. The main rate of duty, which is also the highest rate, is that on imported sugar polarising over 98 degrees (the degrees of polarisation denote the strength of the sugar solution) : lower rates are chargeable on sugar of less polarisation, molasses, glucose and saccharin.

626. Before the War, the main rate of sugar duty stood at 1*s.* 10*d.* per cwt. In 1915-16 it was raised to 9*s.* 4*d.*; for 1916-17 and 1917-18 it was 14*s.*, and from 1918-19 to 1923-24 it was 25*s.* 8*d.* The Finance Act, 1924, reduced the rate to 11*s.* 8*d.* Empire sugar, like Empire tea, was granted a rebate of one-sixth of the full duty from the 1st September, 1919 With the reduction in the full rate of duty in 1924-25 the rebate fell from 4*s.* 3⅓*d.* (one-sixth of 25*s.* 8*d.*) to 1*s.* 11⅓*d.* (one-sixth of 11*s.* 8*d.*), but it was again raised to 4*s.* 3⅓*d.* in July, 1925, the full duty remaining at 11*s.* 8*d.* Between 1920-21 and 1923-24 the proportion of Empire sugar consumed in this country varied from 22 per cent. to 27 per cent. of the total consumption, but in 1924-25 the proportion fell to 10 per cent. It increased again in the year 1925-26 to 22 per cent.

627. The duty per lb. of sugar and the average retail price (so far as it can be ascertained*), with the consumption and duty per head of population, have been as follows in 1913-14 and in the post-war years :—

		Approximate Full Duty.	Approximate Average Retail Price.	Per Head of Population.	
				Consumption.	Duty.
		Per lb.	Per lb.		
		d.	*d.*	lb.	*s.* *d.*
United Kingdom	1913–14	½	2	86	1 5½
	1918–19	2¾	7	Not available.	
	1919–20	2¾	7½	Not available.	
	1920–21	2¾	11¾	55	13 1
	1921–22	2¾	6¾	69	15 6½
Great Britain and Northern Ireland.	1922–23	2¾	5¾	76·9	17 4½
	1923–24	2¾	7	75·8	17 1½
	1924–25	1½	4¾	84	9 3
	1925–26	1½	3½	86·8	8 6

* Mainly from the Ministry of Labour Gazette.

628. While the duty on sugar remained constant from 1918-19 to 1923-24, the average retail price fluctuated between 5¾*d.* and 1*s.* The price has been governed by world conditions.

Before the War more than half the sugar consumed in the United Kingdom came from Germany and Austria. During the War, and particularly in the latter stages, there was an increasing shortage. The purchase and distribution of sugar were controlled by the Royal Commission on the Sugar Supply, who continued to act until February, 1921. The situation remained difficult after the War. It reached a head in 1920, when the Cuban planters, who produced nearly a quarter of the world supply were no longer under the control of the American Government. The Royal Commission state that they were advised of a universal opinion amongst the leading buyers " that the enhanced prices that the planters were demanding were excessive, and that the proper policy for buyers to pursue was to remain aloof until the pressure of stocks in the Cuban ports should compel planters to accept lower prices." " We were strongly urged," they continue, " to conform to this policy; and obviously it could only succeed if generally followed by all large buyers. We therefore confined our purchases to the lowest limit consistent with the maintenance of an uninterrupted supply. The policy failed of its purpose; and from the beginning to the middle of 1920 prices mounted with startling rapidity until, in May, they reached the extravagant figure of 22½ cents f.o.b. Cuba. During this excited period our total purchases of Cuban sugar were only 20,290 tons, and the highest price paid by us for any one cargo was 18.15 cents. In July, 1920, we completed negotiations for the purchase of the whole Mauritius crop of 1920, thus rendering ourselves less dependent upon Cuba. The effect on the Cuban market was soon apparent, and prices straightway began to fall, and continued for the rest of the year to decline, until by Christmas they had reached the low level of round about 4 cents per lb." (Cd. 1300, para. 14.)

629. Figures obtained from the " International Sugar Journal " and other sources indicate that the course of the total world production has been as follows :—

Sugar Production: 1910-11 *to* 1924-25 (*a*).

—	Average 1910-11 to 1913-14.	Average 1914-15 to 1918-19.	1919-1920.	1920-1921.	1921-1922.	1922-1923.	1923-1924.	1924-1925.
	1,000 tons.	1,000 tons.	1,000 tons.	1,000 tons.	1,000 tons.	1,000 tons.	1,000 tons.	1,000 tons.
India (*b*)	2,357	2,701	3,049	2,506	2,533	3,014	3,317	2,537
Rest of Empire.	760	975	924	917	1,016	986	988	1,194
Europe ..	7,677	4,862	2,603	3,688	3,987	4,588	5,066	7,186
Other foreign countries	6,507	8,355	8,617	9,625	10,161	9,538	10,444	12,396
Total World.	17,301	16,893	15.193	16,736	17,697	18,156	19,815	23,313

(*a*) Sugar year commencing 1st October.
(*b*) Consumed locally.

It will be seen that total production overtook the pre-war average in 1921-22, although European production was still about half pre-war. In view, however, of increased world demand, the market continued to be a seller's market. In 1924-25 there was a very substantial increase in production, and this factor, as well as the lowering of the duty by the 1924 Budget, contributed to the fall in retail prices in this country from an average of 7*d.* in 1923-24 to 4¾*d.* in 1924-25 and to 3½*d.* in 1925-26.

630. There is no doubt that, owing to the shortage of available supply, total consumption in this country has continued until recently to be materially restricted since the War (*cf. para.* 627). We think that the high prices must have had a marked effect on the relative consumption of the poorest classes, especially as regards sugar in jam, sweets, &c., the demand for which is more elastic. The reduction of price in the last two years has led to an increase in consumption, and it is now more per head than in 1913-14. There is probably room for considerable further expansion.

631. Regarded simply as a tax, the duty has fallen heavily on the smallest incomes. In 1923-24 the tax on a family of five (man, wife and three children) amounted to something like 8*d.* in the pound, where the income was £100, 6½*d.* where it was £150, and 5*d.* where it was £200 (*see table in para.* 255). Even now, when the duty is less than half what it was, the tax on the very small family income is considerable.

632. *The duties on luxuries.* (i) *Tobacco.*—A table giving full particulars of consumption and duty, 1913-14 to 1925-26, is included in Appendix IX. The main rate of duty is that on imported leaf tobacco (unmanufactured and with the stalks not removed) containing 10 per cent. or more of moisture. This rate governs the rates on other tobacco, but the duties on imported cigars and cigarettes include a luxury surtax.

The imports of manufactured tobacco and cigarettes are comparatively small, the great bulk of the revenue being derived from tobacco which is manufactured in the United Kingdom from duty-paid leaf.

633. Before the War the main rate of duty was 3*s.* 8*d.* per lb. In 1915-16 it was raised to 5*s.* 6*d.*, and in 1917 to 6*s.* 5*d.* From 1918-19 onwards it has been 8*s.* 2*d.*, subject to a preferential rebate on Empire tobacco of one-sixth from September, 1919, and one-fourth from July, 1925.

634. The duty per ounce and retail price of the cheap quality tobacco " shag," largely used by the working classes, have been as follows in 1913-14 and in the post-war years :—

	Approx. duty per oz.	*Approx. retail price per oz.*
	d.	*d.*
1913-14	2¼	3½
1918-19	5	8½
1919-20	5	8½
1920-21 to 1925-26	5	9

635. The duty before the War was a very high proportion of the retail price of the cheapest tobaccos. Although it has been less heavily increased than many of the duties, it has been more than doubled. In spite of the price, consumption has very considerably advanced over the pre-war level. In 1913-14 it was 2·2 lbs. per head. From 1920-21 onwards it has approximated to 3 lbs. The increase over the pre-war level may very likely be due in no small part to the persistence of heavier smoking habits formed by men on active service. In a lesser degree it may also be attributed to the spread of smoking among women. Whatever the cause, the figures are remarkable and do not suggest that the duty has been unduly restrictive. It is no doubt true, however, that the price has had an appreciable effect in limiting the consumption of the poorest classes. The Commissioners of Customs and Excise note in their Twelfth Annual Report (Cmd. 1435) that the fall in consumption in the slump year 1920-21 was due partly to the raising of tobacco prices early in 1920, as well as to general economic conditions.

636. The tobacco duty is a considerable tax on the average or normal consumer of small means. Per head of the population (including children and other non-smokers) it is now about £1 4*s*. per annum. The duty borne by the normal consumer with an income of £150 to £200 ranges perhaps between £3 10*s*. and £5.

637. For the lowest ranges of income the duty is probably not quite so regressive as the food duties owing to its having a rather more restrictive effect on consumption. For the higher ranges again it may not be quite so regressive as the food duties owing to the fact that the tobacco smoked by the more well-to-do classes generally contains less moisture and therefore pays a higher rate. The difference is however very slight, as illustrated in our table in paragraph 255; it does not constitute any real recognition of the greater element of luxury in the more expensive forms of smoking.

638. *The duties on luxuries.* (ii) *Spirits.*—Tables giving full particulars of consumption and duty, 1913-14 to 1925-26, are included in Appendix IX. The figures cover non-potable spirits, where these are liable to duty, as indicated in a note to the first table; such spirits, however, account for an almost negligible proportion of the total.

The duty is charged in accordance with alcoholic strength, the standard unit being a gallon of "proof spirit," containing 57 per cent. of alcohol by volume and 43 per cent. of water. Typical pre-war bottled whisky was about 20 under proof, while typical post-war is 30 under proof. The main rate of duty is that on "home-made" spirits. The duties on all imported spirits (about 16 per cent. of the total) apart from the preferential

rebate are higher by 4*d.* or 5*d.* per proof gallon in order to countervail the cost of Excise restrictions, &c., to the home distiller. In addition, surtaxes are imposed on imported spirits—

(*a*) if sweetened, to countervail the sugar duty;
(*b*) if imported in bottle.

Since the 1st September, 1919, foreign spirits have been charged at a higher rate than Empire spirits.

639. The present position in regard to spirits is bound up with the sequence of events affecting them during the War. In the first year of the War, intensive industrial activity was accompanied by a further rise in the consumption of spirits, continued from the previous years of good trade. Liquor control was instituted in June, 1915, and the various restrictions imposed by the Central Control Board were chiefly responsible for the heavy decrease in spirit drinking in 1916-17. From the 1st April, 1917, onwards clearances were restricted to half those in the calendar year 1916. On the 23rd April, 1918, the duty was increased to 30*s.* per proof gallon; the low consumption of 1918-19 was, however, in no way due to this, since it continued to be determined by the restriction on clearances. The restriction was modified in February, 1919, and wholly removed on the 19th November of the same year. Meanwhile the duty had been raised again, on the 1st May, to 50*s.* per proof gallon. Over 24 million proof gallons were cleared in 1919-20; it may be inferred that they were partly used to restore the depleted stocks of traders. On the 20th April, 1920, the duty was raised to its present high level of 72*s.* 6*d.* per proof gallon, and the consumption has been at something like half the immediate pre-war level.

640. The approximate duty per bottle (approx. one-sixth gallon) and the usual retail price have been as follows in 1913-14 and in the post-war years :—

	Approx. duty per bottle.	*Retail price per bottle.*	
	s. d.	*s. d.*	
1913-14	... 1 11½	4 0	(20 U.P.)
1918-19	... 3 6	9 0	(30 U.P.)
1919-20	... 5 10	10 6	,,
1920-21 to 1925-26	... 8 5½	12 6	,,

641. The persistence of the lower rate of consumption since the removal of control may be put down to a number of causes; among them are the break of habit owing to the restrictions in operation for four years, and the continued depression in trade. The heavy duty, however—about two-thirds of the general ruling price—has practically placed it beyond the reach of the lowest incomes, as anything like a regular drink. Owing to restricted

consumption the comparative figures of duty per head (about 22*s*. 2*d*. in 1925-26, as compared with about 10*s*. 6*d*. in 1913-14) are not in themselves illuminating.

642. In attempting to gauge the amount consumed by persons with incomes up to £200 (*see tables in para.* 255 *and in Appendix* X), we have come to the conclusion that, in the aggregate, it must account for a large proportion of the total consumption. It appears that the man whose normal drink is beer may very commonly consume a sufficient amount of whisky to suffer an appreciable amount of tax. The consumption of spirits varies, in some degree, in different localities; from evidence put before us, it appears that in the North of England a much higher proportion of drink expenditure goes into spirits than in the Midlands, although on the other hand it is much less than in Scotland. In the South West of England the proportion is likely to be the smallest.

643. *The duties on luxuries.* (iii) *Beer.*—In general beer is the staple alcoholic drink of the working classes. A table giving full particulars of consumption and duty, 1913-14 to 1925-26, is included in Appendix IX.

644. The main rate of duty is that on home-made beer. The duty on imported beer is now higher by 1*s*. 4*d*. per standard barrel, in order to countervail the licence duty on brewers, the cost of Excise restrictions to the home brewer and the duty on imported hops. The " standard barrel " is 36 gallons of an original gravity of 1055 degrees. In 1913-14 the actual average gravity was nearly 1053 degrees; during the War it was greatly reduced, under control, and has since risen to about 1043 degrees.

645. During the War consumption was heavily reduced. A comparatively slight reduction followed the increase in taxation in November, 1914, from 7*s*. 9*d*. per standard barrel to 23*s*. From 1916-17 onwards the determining factor was restriction of output, which continued, though with gradually decreasing stringency, till the 1st July, 1919. In 1918-19 the consumption amounted to 12,721,000 standard barrels, as compared with 35,446,000 in 1913-14. Owing to reduced strength, the disparity in the actual amount of liquid was less marked, the comparative figures being 23,060,000 bulk barrels in 1918-19 and 36,947,000 in 1913-14.

646. Side by side with restriction of output, the duty was raised from time to time. On the 23rd April, 1918, it reached 50*s*. per standard barrel; on the 1st May, 1919, it was put up to 70*s*., and on the 20th April, 1920, to 100*s*. It remained at this figure until the 1st April, 1923, as from which date a reduction of 20*s*. per bulk barrel has been in force except in the lowest gravity beers.

647. The approximate duty per pint, and the retail price of the quality commonly sold, have been as follows in 1913-14 and in the post-war years :—

	Approx. duty per pint.	*Retail price.*
	d.	*d.*
1913-14	¼	2½ (1051°)
1918-19	1	5 (1030°)
1919-20	2¼	6 (1039°)
1920-21 to 1922-23	3¼	7 (1042°)
1923-24 to 1925-26	2¼	6 (1042°)

648. It will be seen that before the War the duty was approximately 10 per cent. of the retail price; on a beer of lesser gravity the duty is now over nine times more than before the War. Recent consumption has been rather less than two-thirds that of 1913-14 in terms of standard barrels, and about three-fourths in terms of bulk barrels, although there has been some increase following the 1923 reduction of duty. The main causes of reduced consumption other than taxation are of the same kind as those affecting whisky.

649. Even with reduced consumption, the duty on beer falls with great weight on the average or normal consumer of small means. The duty per head of the population (including children and adults who do not drink beer) is now over £1 16*s*. In a working man's family, where, may be, little or no spirits and wine are consumed, an income of £150 may quite typically bear about £7 or £8 duty, and an income of £200 rather more.

650. *The duties on luxuries.* (iv) *Wine.*—The duty on wine provides only a small part of the revenue from alcoholic liquors. A table giving full particulars of consumption and duty is included in Appendix IX. It will be seen that the rates of duty vary according as the wine is imported in cask or in bottle, according to its strength, and according as it is still or sparkling. The average rate of duty in 1925-26 was about 4*s*. 8*d*. per gallon.

651. For the sake of illustration, approximate figures may be given to show the duty on certain wines, of quality largely sold, in 1913-14 and in post-war years. For champagne a non-vintage wine is taken in order to get comparable prices throughout.

	Approximate duty per bottle.			Approximate retail price.		
	Port Wine.	Light Wine.	Champagne	Port Wine.	Light Wine.	Champagne.
	s. d.	*s. d.*	*s. d.*	*s. d.*	*s. d.*	*s. d.*
1913-14	0 6	0 2½	0 7½	2 3	1 6	4 6
1918-19	0 6	0 2½	0 7½	6 0	4 0	10 0
1919-20	0 6	0 2½	0 7½	6 0	4 0	10 0
1920-21	1 0	0 5	3 3	6 6	4 0	12 6
1921-22	1 0	0 5	2 6	5 0	4 0	12 0
1922-23	1 0	0 5	2 6	4 6	3 0	10 0
1923-24 to 1925-26...	1 0	0 5	2 6	4 6	3 0	9 0

652. As regards the course of consumption during and after the War, we may quote from the Eleventh Report of the Commissioners of Customs and Excise (Cmd. 1082, page 34). After relating the partial prohibition of imports from the 23rd February, 1917, onwards, and restriction of clearances for home consumption from April, 1917, they proceed: "the consumption of wine fell heavily on the outbreak of War in 1914, but it recovered somewhat in the early part of 1915-16, owing probably to some substitution of wine for spirits, the price of which had risen. A decline set in again towards the end of 1915-16 with the result that consumption was probably less in 1916-17 than in the previous year. In 1917-18 consumption was brought much lower by the restrictions on clearances mentioned above, although it was no doubt larger than the clearances indicate, as duty-paid stocks were drawn upon. In 1918-19, with the removal of restrictions on imports and clearances alike, there was a large expansion, helped by the continued shortage of beer and spirits. In 1919-20 clearances, and probably consumption, rose to a figure never before reached."

653. In 1920-21, clearances fell very greatly and consumption to a less (but still great) extent. The fall cannot be accounted for by the increase of the duties, for prices rose only to a moderate extent. The advent of the trade depression was, no doubt, a contributing cause. But the 1919-20 consumption was quite exceptional, being probably due to some extent to peace celebrations, and the figures for 1919-20 and 1920-21 afford no indication of the normal effects of a slump. There was a further fall in 1921-22, bringing the figures below those of 1913-14, but in subsequent years there has been a continuous rise.

654. The duties on wine have been less severely increased than those on spirits and beer, and form a lesser element in retail price. The per head consumption of the wage-earning classes is believed to be very light, but it seems that it varies in different parts of the country and that a fair proportion is often consumed by women. The duties are not a considerable burden to the moderate consumer at any point on the income scale.

655. *Entertainments Duty.*—This duty on the payment for admission to an entertainment was first imposed by the Finance (New Duties) Act, 1916. A table showing the various rates which have been in force in successive years is included in Appendix IX, together with a brief note of the principal exemptions now granted.

It will be seen that the duty as first imposed was ½*d.* for payments of 2*d.* and under, and 1*d.* for payments between 2*d.* and 6*d.* It then rose, by four steps, to 1*s.* for payments between 7*s.* 6*d* and 12*s.* 6*d.*, with an additional 1*s.* for each further 10*s.*, or part of 10*s.*

From 1917-18 to 1923-24 the duty for payments up to 6*d.* was graded from ½*d.* to 2*d.* by steps which were modified in 1918-19 and 1919-20. In 1917-18 3*d.* was charged on a payment between 6*d.* and 7*d.*, but this was reduced to 2*d.* in the following year.

For the same seven years, 1917-18 to 1923-24, the graduation of the duty for payments above 7d. remained unaltered, rising by six steps from 3*d.* on payments up to 1*s.*, to 2*s.* on payments between 10*s.* 6*d.* and 15*s.*, with an additional 6*d.* for each further 5*s.* or part of 5*s.*

In 1924-25 the duty for payments up to 6*d.* was abolished, and reductions were made in the duty chargeable on payments up to 1*s.* 3*d.*

656. The rates of the Entertainments Duty are fixed by reference to price. The following table will illustrate the graduation immediately before and after the Budget of 1924. The payments shown represent in each case (except for the figures in italics) the upper limit of a range to which a differential rate of duty applies or did apply in 1923-24 :—

Payment (excluding tax).	*Approximate Percentage of Duty to Payment.*	
	1923-24.	1924-25.
s. *d.*		
0 2½	20	Exempt up to 6*d.*
0 4	25	
0 4½	33	
0 7	29	14
0 8	*37*	19
1 0	25	*17*
1 1	*31*	15
1 3	*27*	20
	Both years.	
2 0	17	
3 0	17	
5 0	15	
7 6	13	
10 6	14	
15 0	13	
25 0	12	
40 0	11	

Up to 1923-24 the high rates of duty on payments up to 6*d.* and 1*s.* as compared with those on larger payments were an obvious mark for criticism.

657. The revenue derived from the Entertainments Duty has been as follows for Great Britain :—

	£		£
1916-17 ...	2,917,871	1921-22 ...	10,086,479
1917-18 ...	4,843,976	1922-23 ...	9,603,017
1918-19 ...	7,325,063	1923-24 ...	9,284,686
1919-20 ...	10,210,360	1924-25 ..	6,249,344
1920-21 ...	11,504,976	1925-26 ..	5,714,476

The revenue in 1921-22 appears to have been affected by the great increase in unemployment. Wages for employed persons remained relatively high throughout 1921, but in the latter part of 1922 and in 1923 they fell heavily, and their lower level, together with continued unemployment, was no doubt one of the reasons for the further diminution of revenue in 1922-23 and 1923-24. The revenue from 1921-22 onwards has also been restricted in a minor degree by the extension of various reliefs. The great reduction following on the Budget of 1924 (taking effect from the 2nd June, 1924) shows how large a proportion of the receipts had previously come from duty on the smallest payments. It has been estimated that, at the present rates, payments exceeding 6*d.* and not exceeding 1*s.* 3*d.* are responsible for a yield of approximately £3,400,000 out of a total £5,800,000 (H. of C., Official Deb., Vol. 191, Col. 1721).

658. The duty has presumably had some slight effect on expenditure, particularly in the case of the smaller payments in years prior to 1924-25. It may be noted, however, that the price of entertainments has not increased in proportion to the general advance in the cost of living. On this account, and on account of the greatly increased provision of cheap entertainment, the general standard of living seems clearly not to have been depressed so far as concerns the enjoyment of leisure in this direction.

Regarded simply as a tax, the duty under the existing scale appears to be quite a light burden for all classes of income, except where expenditure on amusement is unusually large. Prior to 1924-25 its weight on the smallest incomes was more considerable.

659. *Conclusions.*—In any general conclusion as to the effect of the Customs and Excise duties on the standard of living, it is necessary to bear in mind that the duties contribute substantially to expenditure on education, pensions, unemployment relief, &c., from which the wage-earning classes largely benefit. Again, it must not be forgotten that some indefinable part of the duties—although, as we have said, it does not seem to be a very considerable part—is balanced in many cases by an increase in wage-rates due to the tax element in the cost of living (cf. *paras.* 598-614).

660. When proper allowance is made for these aspects, we consider that the food duties, even at their present reduced level, must still exercise some adverse effect on the standard of living of the poor, although on the whole that standard may be slightly better than in the year 1913-14. We have in mind the fact that, while the tea duty is lower than before the War, the duty on sugar—a prime necessity—is at a rate more than six times that in force before the War.

661. On a survey of the several duties, it becomes apparent that their effects are much linked together The connection is

sometimes obvious, sometimes less so. It is obvious, for example, that the duties on drink and tobacco, to the extent that they are not balanced by reduced consumption, leave less money available for other commodities. It is less obvious, but it is probably the case, that the high duty on whisky has been a factor in stimulating the consumption of tea.

662. The duties on drink and tobacco are a heavy burden on the drinker and smoker of small means, even where the drinking and smoking are less than the general average for consumers. Professor Cannan suggested as one of the points in favour of this taxation, seldom noticed, that "as women drink and smoke less than men, and children scarcely drink and smoke at all, it differentiates in favour of maintaining a family" (*E. in C.*, 13). This statement, we think, goes too far. All that can be said is, that the drink and tobacco duties differentiate against the family man less than the duties on tea, sugar, etc., which women and children consume largely.

663. The weight of the Customs and Excise duties on small family incomes is illustrated in the tables in paragraph 255. Their actual effect on the standard of living is difficult to determine. If the alcohol duties were materially lower, it is probable from past history that lower prices would lead to more drinking and to some increase of excessive drinking; excessive drinking is clearly not conducive to economic well-being, and it would be difficult, in the interest of that well-being, to argue in favour of any increase over the present level of consumption.

On the other hand, it is also probable that lower alcohol duties would release more money for household expenditure. Too much stress should not be laid upon the fact that, while less drink is consumed, total drink expenditure is on a scale similar to that before the War, allowing for the change in price-levels. The smaller post-war consumption of beer and spirits is, we think, due in some degree to a change of habits independent of price considerations, like the larger consumption of tobacco; it is, however, not possible, from a few years of industrial depression and unemployment, to gauge the extent or the solidity of the change.

664. The effect of the Entertainments Duty is much less important, and we need not add to what we have already said under this head (*paras.* 655-8).

665. "Our system of indirect taxation," Mr. Layton observed, "has certainly not reduced the standard of living below that of 1913" (*E. in C.*, 10). This appears to be true; even so, however, we agree with the Trades Union Congress that the system does considerably lower the purchasing power of the poorest sections of the people "and in this manner reduces the demand for such commodities as they would undoubtedly desire to purchase, were they free to do so" (*Ev.*, *p.* 229; *E. in C.*, V. 2-3). In this aspect its tendency must,

in some directions, be adverse to physical efficiency; on the other side it would, we think, be generally agreed that some favourable effect must be allowed at least to the taxation levied on alcohol. Finally, account has always to be taken of the benefits of social expenditure; these are not provided out of any particular branch of revenue, but nevertheless, under the existing scheme of taxation, they are largely rendered possible by the high yield of the indirect taxes.

666. *The higher incomes.*—With regard to the standard of living of the more well-to-do little need be said. As indicated by the tables in paragraph 255, the burden of the food duties is soon negligible in comparison with that of the Income Tax, while the burden of indirect taxes, as a whole, quickly takes a secondary position and in the largest incomes is insignificant. The regressive nature of the duties is, of course, corrected by the progression of the Income Tax.

667. The duties on drink, tobacco and entertainments no doubt induce some extra economy among those enjoying moderate incomes, and some shifting of expenditure to non-dutiable goods. In the larger incomes their effect is comparatively little.

II.—The Effect of the Customs and Excise Duties on Saving.

668. Much the greater part of the Customs and Excise revenue is contributed by persons who are not liable to Income Tax. It follows that, so far as the revenue is applied (on a proportional basis) in payment of interest to holders of National Debt, an important transfer is involved from a very great number of small incomes, with little margin for saving, to individuals and bodies whose facilities for saving are much more ample. Of the duties borne by small incomes, by far the larger part will be met out of money which would otherwise be expended on consumption goods of one kind or another; a much smaller part will be so expended by the debt-holders out of their interest receipts. In the case of debt repayment it is probable that nearly the whole of the sums received will be reinvested.

669. Similarly, of the smaller total of Customs and Excise duties borne by the Income Tax paying class a proportion* must be allocated to debt payments. Since there can be no doubt that, over the class as a whole, receipts of debt interest are much more steeply graduated according to wealth than payments of duty, a smaller proportion is likely to be absorbed

* Throughout we have regarded the revenue from each tax as proportionately applied to each head of expenditure. We reject the view which regards the service of the debt as a first charge on the Income Tax revenue (*cf. footnote to para.* 266).

in consumption expenditure than if the money were left in the taxpayers' pockets; again, as we have said, repaid debt will nearly all be reinvested.

670. On a general view it appears that, so long as internal debt expenditure bears as high a proportion to total expenditure as at present, the existing Customs and Excise duties can have no great effect on total national savings. Indeed, so far as the Income Tax paying classes are concerned, it seems that the effect of the duties is to some slight extent definitely favourable to saving. In this aspect the duties are very satisfactory from an industrial standpoint. At the same time, it has to be remembered that they react harmfully on trade, so far as they are damaging to physical efficiency, and so far as their effect on the cost of living increases wage difficulties and discontent. It is in their effect on the standard of living of the poorer classes—which has to be considered primarily in relation to the well-being of the individual and the family—that they may seem to provoke criticism; we have, therefore, devoted our main attention to this latter aspect.

SECTION V.

THE BURDEN OF THE DEBT AND EXISTING TAXATION, DIRECT AND INDIRECT. BROAD CONSIDERATIONS AND CONCLUSIONS.

671. We have discussed the standard of saving and the standard of living before and since the War (Section I); we have analysed the growth of the debt and commented on some of its main features (Section II); we have given figures showing the progress of the tax revenue from 1913-14 to 1925-26, and have expressed the various taxes in terms relating them to incomes of different sizes (Section III); finally, after glancing at the several heads of expenditure, we have examined the incidence and effects of each tax in turn (Section IV). We are now in a position to take a more general view of the whole burden of debt and taxation.

672. First, we may briefly notice two kinds of comparison which are frequently made, (i) between the position of this country and of other countries, and (ii) between the position of this country to-day and in the era following the Napoleonic Wars. This second comparison will give us a text for discussing the prospect of any future increase of productivity.

673. *Comparative burden in different countries.*—The question of comparative tax burdens and taxable capacity has been much discussed in connection with debt and other settlements between different countries and in conjunction with the problem of transferring resources from one country to another. We are not concerned with the question in this aspect, but we are interested in the comparative burdens, so far as the weight of taxation in Great Britain may prejudice our industry in competition with that of less heavily taxed countries, through impeding the growth of reserves, checking enterprise, and so forth.

674. That this factor has to some extent affected our industry we do not doubt, although we regard it as of minor importance compared with more general difficulties affecting our foreign trade (*cf. paras.* 402 and 445 *et seq.*). We have, however, reluctantly come to the conclusion that the available material is insufficient on which to found any reliable statistical conclusions. It is significant that the First Committee of Experts

appointed by the Reparation Commission, to whom the question of comparative taxation was vitally interesting, did not attempt to present figures. As they explained in their Report, "the comparison of statistics of total taxation, national and local, in each country presents many technical difficulties. Moreover, statistics of total national income and income per head are at present either very defective or wholly lacking." (Cmd. 2105; p. 48).

675. In reference to the post-war period up to the end of the last completed tax year, we think it may be said definitely that the burden of taxation was heavier in Great Britain than in any other European country, and very much heavier than in the United States. But we are not prepared to make a measured comparison in figures. It is dangerous to draw facile inferences from partial statistics, such as have appeared from time to time, and we think it may be of service to point out some of the very difficult questions, an answer to which would be presupposed by any really scientific measurement:—

What is the proportion which total taxation bears in each country to the total national wealth or income?

What is the amount of tax per head in each?

What is the comparative distribution of wealth or income?

What is the incidence of the taxes, and how are they adjusted to the distribution of wealth or income in each country?

What is the general character of each country's industry—does it make greater or less demands for capital equipment?

What are the objects of Government expenditure—to what extent are they economically productive?

What is the relation between national and local finance?

What policy is followed in carrying on municipal and national industries for profit or loss in remission of, or addition to, taxation?

What are the social conditions and standards of living?

Even if it were possible to value all these factors precisely, there would remain the important element of comparative psychology. Thus, if it could be found, in answer to the above questions, that the burden in country A was 10 per cent. greater than in country B, country B might still compete at a disadvantage if the thrift and enterprise of its citizens were the more seriously affected.

676. *The Napoleonic War parallel.*—Mr. Layton gave us an interesting table, comparing for 1818, 1913 and 1923 the proportion of various kinds of Government expenditure (excluding

expenditure of the Post Office) to national income (*E. in C.*; 9 (vi)). We reproduce this here :—

—	1818.	1913.	1923.
	£ Millions.	£ Millions.	£ Millions.
National Income	400	2,300	3,800
Internal Debt Service—			
Interest and Management ...	31·28	16·94	271·45
Debt Repayment	1·22	7·56	28·54
External Debt Service—			
Interest and Management ...	Nil.	Nil.	35·85
Debt Repayment	Nil.	Nil.	11·46
Pensions (War and Old Age) ...	1·20	12·46	92·95
Defence	14·50	77·18	105·80
Other Services	6·70	54·26	182·15
Cost of Collection (Inland Revenue and Customs and Excise).	3·88	4·48	10·82
Total Expenditure	58·78	172·88	739·02
Total National Debt	840	650	7,700
	Per cent.	Per cent.	Per cent.
Ratio to National Income of—			
Internal Debt Service—			
Interest and Management ...	7·82	0·74	7·14
Debt Repayment	0·30	0·33	0·75
External Debt Service—			
Interest and Management ...	—	—	0·94
Debt Repayment	—	—	0·30
Pensions (War and Old Age) ...	0·30	0·54	2·45
Defence	3·62	3·36	2·78
Other Services	1·68	2·36	4·80
Cost of Collection	0·97	0·19	0·29
Total Expenditure	14·69	7·52	19·45
National Debt	210·00	28·26	202·63

677. *1818 and 1923.*—In some respects there is a striking similarity between the present position of the country and that after the Napoleonic Wars. The parallel, however, needs to be regarded with caution. In particular, we have to consider whether the remarkable manner in which the debt-burden of a hundred years ago was lightened in course of time through increase of wealth and population gives any ground for optimistic views to-day.

678. On the basis of the estimates of national income shown in the above table, taxation for the internal debt accounts for very much the same percentage each year. The ratio of total tax revenue to national income was 14·07 per cent. in 1818 and 18·89 per cent. in 1923, the higher ratio in 1923 being largely due to expenditure on pensions and social services. It is not necessarily implied that the burden in 1923 was the heavier; as in a comparison between different countries, so also in a comparison affecting the same country at different times, many points require attention. We suggest especially the following :—

(i) Population has increased greatly, but wealth much more greatly. Only rough comparisons are possible, but after allowance for differing price-levels, it appears that real income per

head was something like four times as much in 1923 as in 1818. All classes shared in this increase, real wages and the standard of living having made a big advance during the nineteenth century.

(ii) While the mass of the people suffered acutely in the depression of a hundred years ago, and had much less capacity than now to bear taxation, the distribution of tax was far more severe to small incomes.

Of a total tax revenue of £56 millions, £40 millions was raised by Customs and Excise duties, levied largely on necessaries, the Income Tax having been repealed as from April, 1815.

(iii) Taxation in 1923 provides for many social services either not represented at all, or barely represented, in the State expenditure of 1818.

(iv) The very numerous and vexatious indirect taxes in force in 1818 were a serious impediment to trade.

(v) As against these considerations we must note that in 1818 there was no external debt charge.

(vi) Again, taxation in 1818 hardly touched the saving power of the wealthy ; in 1923 it imposed a distinct limitation upon it.

679. Reviewing these points, we think it clear that, for some years after the Napoleonic Wars, debt and taxation were far more burdensome to the nation as a whole than they are now. They were certainly far more oppressive to the poorer classes. Relief came in the Victorian era through the unprecedented advance in industry and transport and in the development of the credit system, accompanied by rapid growth of population. The burden of the debt was spread over a body of taxpayers growing in number and prosperity. It is true that the dominant changes in the price-level were large falls between 1818 and 1852 and again (almost without interruption) between 1873 and 1897, so that greater purchasing power had to be transferred to the debt-holder, at any rate until the reduction of interest under the Goschen conversion of 1889; none the less, the necessary taxes were provided with increasing ease. The following figures are significant :—

Date.	National Income.	National Debt.	Debt Charge.	Population.	Income per head.	Approximate Debt Charge per head.	Index number (based on Jevons and Sauerbeck).	Index figure of Income per head (1818 = 100).	Index figure of Debt Charge per head (1818= 100).
	£ millions.	£ millions.	£ millions.	£ millions.	£ s.	£ s. d.			
1818	400 ...	840	32·50	17	23 11	1 18 0	160	100	100
1864	814 (Levi)	816	28·96	29·7	27 8	0 19 0	105	177	76
1875	1,200 (Giffen)	766	27·44	33	36 7	0 16 6	96	257	72
1891	1,600 (Bowley).	682	25·26	38	42 2	0 13 3	72	397	77
1913	2,300 ...	656	24·50	45·9	50 2	0 10 6	85	400	52

680. *Future productivity.*—The question of future productivity in Great Britain is open to speculation. A large growth in population, if it were to take place without a corresponding expansion of trade, would not ease the position, but would rather increase anxiety as to employment. In point of fact, there is no evidence in present conditions to suggest a large growth; according to an estimate which we have prepared, the numbers of the occupied population, after allowance for emigration, may be expected to increase by about 125,000 per annum up to 1931, about 46,000 per annum between 1931 and 1936, and about 20,000 per annum between 1936 and 1941 (*see Appendix* XXI). The numbers seeking employment after 1941 depend on the birth-rate from now onwards. Professor Bowley has pointed out that " the present number of births (and the present death-rates) would ultimately result in a stationary population in Great Britain not far off 50,000,000."* In evidence before us he said that, while considerations such as the connection between the birth-rate and good or bad trade, housing conditions, etc., made any forecast difficult, he thought that on the whole there would be a tendency for the present conditions to continue for quite a long while, and that the number of births was not likely to change very much in the near future. (Q. 3787-9.)

681. It appears then that, apart from the maintenance of a low level of unemployment, such as would be facilitated by a steady foreign demand for our goods, any hopes must be centred mainly on an increase of productivity per head. This might come in various ways, from the discovery of new materials, new inventions, advance in chemical and other sciences, and improved organisation. To secure the full potential results, it might be necessary to lay out a considerably larger amount of capital than hitherto per unit of the employed population. Professor W. R. Scott expressed the view that " in spite of the existing depression, which tends to produce an unduly pessimistic estimate of future production, there seem to be grounds for a fairly confident expectation of a very considerable development in methods of production within a generation from now, particularly in the application of scientific discoveries to industry, with a consequent tendency to greater plentifulness of commodities." (*E. in C.* 2.) We think this expresses a reasonable attitude.

682. On the whole subject we conclude that the present burden, in spite of its weight, is less menacing to the welfare of the community than the old debt continued to be for some years after 1815: there is reason also to hope that it may be materially lightened through new developments in industry. On the other hand there is nothing to warrant a belief that history will repeat itself and productivity increase on a scale like that of the Victorian era.

* *Manchester Guardian*, 9th November, 1925.

683. In looking to the future burden of the debt, we have also to remember the uncertainties of the general rate of interest and the general price-level. As regards the price-level, it may be surmised that any very marked increase of productivity per unit of capital and labour would tend to lower it, though not necessarily to a corresponding extent. While lower prices due to such a cause would increase the purchasing power to be transferred to the debt-holder, this would only be a slight set off against the general benefit enjoyed by the community. A fall in the price-level without any compensating increases in production would be quite another matter. We consider it in connection with the Capital Levy (*para.* 737 *et seq.*).

684. *Post-war debt and expenditure.*—In considering post-war years, it is frequently useful to take the pre-war position as a standard of reference, and the figures in Mr. Layton's table (*para.* 676) are of much interest. We have already discussed the weight of the several taxes before and since the War (*cf. especially paras.* 331, 464 and 593). It may be noted that debt service constituted 55 per cent. of the total expenditure in 1818; 14 per cent. in 1913; and 47 per cent. in 1923. In 1913 the total burden of taxation was then considered to be very heavy (*cf. para.* 433). During the War it was enormously increased—though with caution at first—and the country learnt that it could carry a great deal more taxation than it had supposed. Emphasis is often laid upon the effect of taxation for the debt in limiting the possibility of expenditure on social, etc., objects, but, whatever truth there may be in this view, the discovery of the possibility of expansion in taxable capacity during the War has in itself been conducive to social expenditure, which has actually grown to a large extent. The pre-war tendency was towards an expansion in social schemes, but it may possibly be doubted whether, but for the War, they would have developed as far as they have.

685. *Taxation and the individual.*—The table in paragraph 255, which relates the various taxes to specimen incomes, will serve to illustrate how remarkably the principle of progression has been developed since 1913-14 in direct taxation. Except in the small incomes which are liable to little or no Income Tax, the general character of the present tax system is highly progressive. The table also shows the regressive nature of indirect taxation. It may be noted that the taxation on the smallest incomes, while heavier, appears to be rather less regressive than before the War; this is due in some measure to the high prices of tobacco and alcohol restricting the consumption of the least well-to-do.

686. Progressive taxation, under which income, as it increases, bears tax at a higher rate per pound, is the fairest as between individual taxpayers, since it allows for the increased capacity

of each additional pound of income to bear taxation (*cf. para.* 330 *et seq.*). The principle of progression may, however, be carried to such a point as to lead, in turn, to unfairness against the wealthier taxpayer. Regressive taxation, under which income, as it increases, suffers at a lower rate per pound, is deficient in point of equity. It might be inferred that a good tax-system would give no place to indirect taxes, which cannot be fitted to the individual's ability to pay, and which are unavoidably regressive, if levied upon articles of general consumption. Such a conclusion would miss the mark for several reasons :—

(i) Indirect taxation is the most effective way of levying a contribution to national expenditure from the mass of wage-earners. A universal Income Tax would be very unpopular and difficult to administer. On the other hand, to raise the whole revenue from direct taxes on two or three million citizens would be unduly to narrow the basis of taxation. There is great force in the argument which connects taxation with representation.

(ii) Progressive taxation, such as the present Income Tax and death duties, cannot be carried beyond a certain point without jeopardy to saving and enterprise. Harm may be done to trade, and, if so, there will be reactions on employment and on the standard of living of the poor. Thus the system may break down.

(iii) While indirect taxes, such as the Customs and Excise duties, are regressive, they may have special virtues. This is true of the tobacco and alcohol duties, which raise a large revenue out of the expenditure of individuals in all ranks of wealth, without undue reactions on personal efficiency.

687. *Taxation and the citizen.*—We consider it important on broad grounds of citizenship that taxation should not be confined to a comparatively small section of the population. It would be a bad state of affairs if a large majority of citizens were themselves to make no actual tax contribution, and were to enjoy benefits provided entirely by the taxation of the few. Under conditions approaching the ideal—which would imply, *inter alia*, a satisfactory standard of living for the lowest-paid workers—all would make some contribution, and would make it knowingly.

688. The actual position is that all classes make some contribution, and this in itself we regard as satisfactory; but the great majority contribute only in the form of indirect taxes, and these, being wrapped up in price, are so unobtrusive that they are probably not much realised, except when attention is specially drawn to them. It would be better, from the point of view we are considering,* if the great body of citizens were more conscious of the taxes which they bear. The question is

* From the point of view of ease of collection the unobtrusive character of indirect taxation is, of course, an important virtue.

partly, though not wholly, one of " taxation and representation " It appears to us that it would be damaging to the sense of responsibility in an electorate that a large section should be able to vote for some perhaps expensive policy, feeling all the while that, because they were not personally liable to taxation, the expenditure would not touch them in any way. It is sometimes argued that the poor, since they are the first to suffer from bad legislation, would not be likely to vote irresponsibly even if entirely immune from taxation. The argument seems, however, to be defective; for the cause of suffering may not be clear; moreover, we have to consider, besides legislation which is positively bad, legislation the benefits of which, although real, do not sufficiently outweigh the damage done to the community by the attendant taxes—in other words, legislation which is " bad value for money."

689. *Standards of living and saving.*—We have compared the pre-war and post-war standards of living and saving in paragraphs 9-44 and 45-60, respectively.

We need not summarise again the complicated effects of existing taxation under these heads. Reference may be made to the summaries in the following paragraphs :—

Standard of living.
Income Tax, paragraph 439.
Death Duties, paragraphs 545-6.
Customs and Excise Duties, paragraphs 659-67.

Standard of saving.
Income Tax, paragraph 440.
Death Duties, paragraph 547.
Customs and Excise Duties, paragraphs 668-70.

690. A general conclusion we reach is that the post-war taxes, combined with other factors, do not appear to have reduced the *average* or *general standard of living* of the working classes below the pre-war level. The pre-war level, however, even in a boom year like 1913, has no claim to be considered final; a higher standard, such as increased production might bring, is much to be desired. There is no doubt that the Customs and Excise duties considerably affect the purchasing power of people with small incomes and bear hardly on large numbers in the depressed industries, whose real wages have fallen, and who suffer much from unemployment. A clear distinction must be drawn between the duties on luxuries and those on necessaries; we think that the sugar duty is relatively high, even in the financial needs of the present time. While the effect of the duties is to some extent adverse to the standard of living (and, as a consequence, to physical efficiency), there is a set-off, even if its importance cannot be measured, so far as the alcohol duties—and some would add the tobacco duty—curtail excessive

consumption; this effect cannot be ignored, although the idea of taxation as an element in social reform should in our view, take only a very subordinate place. As always, it is necessary to keep in view the expenditure side of the account, and credit must be given to the Customs and Excise duties for their proportional contribution to education, pensions, &c. Moreover, the direct taxes contribute largely to these social benefits, assisting the workers' standard of living and purchasing power at considerable expense to the living and saving standards of the well-to-do.

691. In regard to the *standard of saving*, we conclude that the increased direct taxes have contributed appreciably to a *pro rata* decline in saving—not startling, but very substantial—below the pre-war amount. The deficiency below the standard of 1913 may be as much as £150 millions to £200 millions in present money values. The decline, whatever its cause—and taxation must not be over-emphasised—is a feature to be watched with some anxiety. It is true here, as it is in the case of living standards, that there is nothing sacrosanct in the pre-war level. It would, however, be most unsatisfactory, if we had to look forward to a permanently lower level of saving. The capital needs of the future may be great.

692. A balance has to be struck somewhere between the claims of individual equity and the social need of saving. In the Victorian era it is generally true that saving was left as a monopoly in the hands of the wealthier classes, who were allowed to remain in almost complete control of their riches. In our view it is impossible to justify the old distribution of taxation, even though it reduced interference with saving to a minimum. It is true that under it industry advanced enormously, and the standard of living improved for the whole community more than in any comparable period. Nevertheless, a tax system falling less on the purchasing power of the poorer classes and more on the savings of the richer might have been beneficial to production, as it certainly would have been to immediate consumption.

693. In the last 20 years before the War, the rate of saving continued to expand, but it answered to a big demand, especially from abroad. It is not clear that the recent lower standard of saving has been inadequate to the actual demand for capital. We have no doubt that, with trade revival, there will be an expansion in the margin of saving, and the increase may be very rapid, as Lord Bradbury suggested (Q. 9242). At the same time, we cannot take for granted that there will be no shortage. In view of the large amount of revenue which has to be raised, we think the general character of tax distribution in post-war years has been satisfactory, but we would emphasize that highly progressive taxation is a growth of the last decade, and it is still too early to speak of its final economic effects on

the community. Growing experience must, therefore, be looked to for guidance as to the best disposition of taxes. We observe that the notion of aiming at a fixed proportion between direct and indirect taxation continues to figure largely in public discussion, a 50-50 relation being often referred to as if it had rare intrinsic merit. We regard this idea as wholly unfounded, and contrary not only to the science of taxation but to plain common sense.

694. *Business enterprise.*—Savings, as we have said (*para.* 440), depend on saving or economy on the one side, and work and enterprise on the other. For a summary of the effects of taxation on business enterprise we may refer to the following paragraphs :—

Income Tax, paragraphs 445-51.
Death Duties, paragraph 547.

Very briefly we may say that, in business generally, the existing taxes tend to discourage a sanguine outlook. The Income Tax has little direct effect on public companies, and the death duties none. Private concerns are much more susceptible to influence. In the middle range of incomes, the Income Tax frequently leads to a greater output of effort, although individual reactions vary widely; in the higher range the tax (including Super-tax) tends to check enterprise, especially of the more speculative kind. The effects of the death duties are less pronounced in either direction.

695. The enterprise of public companies receives some indirect check, so far as their reserves and the supply of capital from the public are diminished; in the case of private concerns, which depend on an internal supply of capital, the material basis for enterprise is more seriously affected, especially where there is heavy liability to Super-tax or where death duties come at an embarrassing time. In the majority of cases, however, the position is eased through the proprietors having relatively large additional resources outside their businesses.

696. *Savings and employment.*—One aspect in which savings have to be regarded is their function in relation to the needs of an increasing population. Mr. A. M. Samuel suggested that an annual provision of something like £160 millions out of national savings is required in order to keep pace with the growth of numbers, this sum allowing £400 per head for 400,000 persons (*Ev., p.* 78, *general observations*). In the course of his evidence (Q. 1074-1093) he showed that he was not bound to these particular figures; the matter, however, is one of importance, and the degree of its importance depends almost entirely on the scale of magnitude of the figures, as Mr. Samuel's own argument illustrates. Starting with the £160 millions, he added £88 millions, the Sinking Fund provision of 1923-24, and then proceeded to say that he did not believe we had saved earnings in that year totalling £248,000,000. "Therefore, by

the amount we had less than the £248,000,000 that you had to find—those two sums of £160,000,000 and £88,000,000—you have drawn on capital, and if you have drawn on capital, you have reduced the possible earning power of the country." (Q. 971.)

697. There are several points here which call for comment. The first is that the inclusion of the £88 millions Sinking Fund provision in the net amount on which taxation should not encroach is fallacious, for we have seen that taxation for Sinking Fund is an actual support of national savings. We may therefore confine ourselves to the £160 millions figure. In regard to this we may observe that while, before the War, the natural increase in population (excess of births over deaths) was about 400,000 per annum, in the four years 1921 to 1925 the average natural increase was little over 300,000, and against this has to be set the annual loss by migration in those years, which was round about 90,000. The present growth of population is thus brought down to about 200,000 per annum, and assuming the necessity of providing £400 for every unit, we get £80,000,000 as the sum to be found. With regard to the national savings we should judge, on such evidence as we have received (*cf. paras.* 45-47), that they were somewhere in the range between £450 millions and £500 millions. Provision of £80,000,000 for growth of population would, on this showing, account for something between 18 per cent. and 16 per cent. of the national savings.*

698. But we now come to another important point. In dealing with this subject, it is necessary to keep clear (i) the necessity for an increase in the supply of commodities in order to maintain the standards of living of a growing population, and (ii) the necessity for capital in order to provide employment for an increasing body of workers, the worker receiving a sufficient share of the produce of labour and capital to enable him to maintain himself and his dependants at the requisite standard. In our view, it is only to the second of these necessities than any figure representing new capital requirements can usefully be related.

699. We have estimated (*see Appendix* XXI) that the number of new entrants into the labour market is likely to average about 125,000 up to 1931, about 46,000 from then till 1936 and about 20,000 from 1936 to 1941. To diminishing figures on some such scale as this we have to relate some figure of capital per head. Sir Hugh Bell told us that in his business before the war about £250 was needed to set a man to work(*E. in C.*, 12); he was of the opinion that " in the last 10 or 15 years the capital cost per unit in the British steel works has greatly increased, and

* The fact that overseas borrowings are proceeding without any apparently dangerous strain suggests that there is little danger of savings being reduced below the minimum required for the country's internal needs.

tends to increase more and more" (Q. '8444). In regard to industry as a whole his general impression was that a tendency existed to increase the capital per unit (Q. 8446). Professor Bowley thought that we should have to look to the necessity, in the future, of having more capital per head rather than less, if we were to keep abreast of possible developments (Q. 3837). The capital employed per head varies, of course, very greatly in different industries. It may be that £400 per head is a little on the high side for the actual present position, but it may well become desirable in the near future to provide considerably more than that figure. Taking £400 in conjunction with the increase of occupied population we get the following hypothetical estimates of the necessary provision of new capital for the particular purpose in view :—

£50,000,000 average per annum up to 1931.
£18,400,000 average per annum from 1931 to 1936.
£8,000,000 average per annum from 1936 to 1941.

No high degree of accuracy is claimed for these figures, but they suffice to show that provision of capital according to old standards, and sufficient to maintain the existing rate of production and the *status quo* of the standard of living, can continue to be found without the least difficulty, and is not imperilled by the present scale of direct taxation.

700. It must be remembered, of course, that the figures quoted above represent only a small fraction of the savings needed in order to cover losses due to wastage and obsolescence of assets, and to provide for factories, plant and machinery, &c., in line with the latest improvements and inventions. Again, the figures are exclusive of savings needed for investment abroad, which are especially important for the development of the Dominions and the maintenance of food supplies. The sufficiency or otherwise of savings in all these directions is involved in the question whether the country can maintain not merely the *status quo* of production and the standard of living, but also a *rate* of improvement per head comparable with that of some periods in the past, or with that now shown in the United States of America. As we have indicated, a revival of trade may bring opportunities requiring a large expansion in the rate of saving, if they are to be fully used.

701. *The general burden.*—Our analysis of the taxation required for the debt and for other expenditure leads to broad conclusions which will have become evident. The burden of indirect taxation appears formidable when viewed as a whole. On analysis, however, it is found that the duties on food are now light except for the sugar duty, which we consider relatively high. The high level of the duties on luxuries (as we understand the term—*cf. para.* 615) appears to us to be justifiable at present, considering the large amount of revenue required, and the risk of interfering too much with savings, if heavier direct taxation were adopted.

702. The burden of direct taxation, while we do not wish to belittle it, is less crushing than is frequently represented. It does not, with trivial exceptions, enter directly into prices, and its indirect effects are not such as substantially to affect the general price-level. It has a materially adverse effect on savings, but this does not hold good, so far as the receipts are applied to payments on account of the internal debt. Again, it has widely diffused psychological effects, and has been responsible for a good deal of discouragement, while trade has been suffering from long-drawn-out depression due to wider causes; on the other hand, some of the psychological effects have been actually beneficial. In our opinion the present taxation—even in conjunction with the loss of material wealth due to war expenditure, which lies behind the National Debt—is not one of the main causes of industrial difficulty. Causes other than taxation lie outside our province, but, in their very wide range, have been under the consideration of the Committee on Industry and Trade. For an analysis of the serious difficulties of our export trade due to one set of causes—conditions prevailing in the various markets abroad—we may refer to the Committee's introduction to their *Survey of Overseas Markets* (1925). The overseas conditions dealt with cover the decline of purchasing power, the shortage of capital, the growth of local manufacture, &c. So far as taxation is concerned, we think that, if general conditions improve and times become more prosperous, the burden will be carried with comparative ease. We base our conclusions, not on preconceptions, but on the long analysis contained in the foregoing part of our Report, in the light of which they must stand examination. We may perhaps remark that the view which we take is more optimistic than the view which attributes to taxation a very large responsibility for the present industrial position; for, while there is little prospect of any great lightening of the tax burden in the early future, there is legitimate hope that in many respects more general conditions, both at home and abroad, may improve.

PART II.

SECTION I.

THE CAPITAL LEVY.

INTRODUCTION.

703. The proposal that a levy should be imposed upon all accumulated capital wealth, and the proceeds used specifically for the redemption of debt, is so far-reaching, and has been so actively debated, that it stands out as having a strong claim to special consideration. We therefore issued a series of questions to witnesses who offered or were requested to give evidence on this subject (*see Appendix* I).

704. In the replies to those questions a levy has been justified by its advocates on many different grounds, but in general the outstanding point in their case is that it would bring about a saving in interest charges on the debt. While they admit that this saving would be to some extent offset by a reduction in tax revenue following the levy, they take the view that the net relief to the Budget would still be such as to make possible substantial reductions in taxation, or an extension of expenditure in other directions, or a combination of both.

705. They also lay emphasis upon the advantage of repaying debt immediately, if a further fall in prices is anticipated; upon the desirability of having a much reduced debt in the event of a national emergency; upon the more even distribution of wealth which would follow a levy; and upon the alleviation of the sense of injustice at the continued existence of so large a debt which they believe to be felt by a large section of the population.

706. The opponents of the levy, on the other hand, consider that the net relief to the Budget would be too small to justify a taxation experiment on so grand a scale, and that, in so far as the net saving might be used to meet additional expenditure, any gain would be largely neutralised. They generally anticipate that a levy would have injurious effects on trade and industry in many directions, that the ensuing dislocation would have serious effects on employment, and that the credit of the country abroad would sustain a shock. They consider that a levy could not be so equitably adjusted to ability to pay as a tax on income, and often emphasise the unfairness of the burden which it would throw on the life savings of the thrifty. Finally they regard the political and administrative difficulties of a levy as exceedingly great.

707. The order of our discussion will be as follows:—

	Paragraphs.
(i) Practicability of a levy	708-17
(ii) Scale, etc., and yield of a levy: resultant annual saving of interest...	718-36
(iii) The levy and the price level	737-43
(iv) The question of a guarantee against repetition	744-48
(v) Methods of payment; effect on value of securities	749-65
(vi) Effect on Government rate of borrowing	766-8
(vii) The levy and national credit abroad ...	769-70
(viii) Effect of a levy on bank advances ...	771-90
(ix) The levy and private businesses ...	791-801
(x) The levy and agricultural landowners...	802
(xi) The redistribution of saving power ...	803-9
(xii) Psychological effects of a levy on saving and enterprise of individuals ...	810-31
(xiii) The redistribution of wealth	832-36
(xiv) The equity of a Capital Levy	837-59
(xv) Capital Levy: summary and conclusion	860-77

I.—PRACTICABILITY OF A LEVY.

708. The first question that has to be faced is that of the practicability of a Capital Levy, a matter on which the opinions of witnesses varied greatly. The history of taxation gives practically no direct guidance. A levy on a large scale, collected over a short period and in other respects comparable with the proposal as understood in this country, has not in fact been tested anywhere (*see Appendix* XXIV); further, owing to differing political and economic conditions, inferences could only be drawn from one country to another with very great caution.

709. However, the experience of other forms of taxation in this country, particularly of the death duties, provides some basis on which to proceed. We print as Appendix XXII a note by the Board of Inland Revenue on the Practicability of a Capital Levy.

The Board illustrate by reference to the success of the Excess Profits Duty and the failure of the Land Values Duties the primary importance of the attitude of the taxpayer to any large scheme of new taxation. They point out very forcibly the dangers that might befall the administration of a levy, either if there were systematic obstruction or if there were widespread anxiety. The importance of these considerations can hardly be rated too high. We do not see how so difficult a task as that of a levy could be carried through with any real success unless it were received with a fair measure of equanimity and assent.

710. It seems clear that a levy would be less readily accepted now than it would have been in the first year after the War. Views to this effect were expressed by several witnesses including advocates as well as opponents of the levy. As to the degree of goodwill that might still be hoped for, there would be less agreement. In order to judge the all-round merits and defects of the proposal, we must leave open the possibility of its being either well or ill received, and consider it in the light of both alternatives.

711. The Board of Inland Revenue, while they view the levy as " a task of the first magnitude " even under the most favourable conditions, do not regard the inherent difficulties as too great to be overcome. They state—thus confirming the supposition of the Trades Union Congress (*Ev.*, *p.* 588; *E. in C.*; 24) —that from the technical point of view the difficulties of assessment would normally be less than in the case of the proposal for a levy on war wealth, which was under consideration in 1920, and which they held to be workable. They add that the task of valuation, would be " essentially similar to that regularly undertaken for purposes of Estate Duty " (*Appendix* XXII; *para.* 8).

712. A source of difficulty which we have had in mind from the first is the large amount of settled property in this country. Among the questions which we addressed to witnesses was one regarding the position on the death of a life tenant, supposing the year of his death not to bear out the forecast of life on which his interest had been valued. The difficulty as regards life tenant and remainder man was generally recognised by the witnesses. Professor Pigou suggested that the life tenant, instead of paying a lump sum on a valuation of his interest, should make his contribution in the form of a special Income Tax, leaving the corpus of the estate to be attacked when the settlement fell in (*Ev.*, *p.* 437; *E. in C.*; 17). As, according to the Board of Inland Revenue, about one-sixth of the total property liable would be settled property, this procedure would very much delay the gathering in of the amount anticipated to be raised by the levy. We do not think it should be adopted, except under necessity. Similarly, any system applying payment by instalments to the case of all settled property, with a provision allowing valuations to be reopened, would postpone the completion of the levy, and would add to its complication.

713. The difficulties connected with the valuation of interests in settled property are many and varied. An idea of their complexity can be obtained from a study of the official memorandum on the subject put in by the Board of Inland Revenue to the Select Committee on War Wealth, and published with the proceedings of that Committee (*H. of C.*, 102, of 1920, pp. 244 *et seq.*). While the Board, in the note which they supplied to us, do not suggest that the problem of dealing with the

separate interests would be incapable of solution, they explain that it would be more serious for a Capital Levy than for the War Levy proposal. They point out, however, a possible method of avoiding these special difficulties altogether. "An alternative course would be for the levy to be imposed, not on the separate interests of individuals and payable out of their estates, but on the whole value of settled property and payable out of the settled fund, the rate of duty both for the settled fund and for the free wealth of the life tenant being found by aggregating the value of the settled property with the life tenant's other property. If this course were taken, the problem would be assimilated roughly to the same level as that arising in the case of free assets" (*Appendix* XXII; *para.* 12).

714. This manner of treating the settled property would agree with that now in force for the Estate Duty. For that duty the settled property has normally to be aggregated at its full value with the free property of the deceased. The duty appropriate to the settled property is thus determined by the range of principal value within which the total estate falls; it is payable in the ordinary course by the trustees of the settlement out of their funds.

715. The procedure has, it is true, a somewhat different appearance in the two cases. In the case of the Estate Duty it falls naturally within the general principle under which all property passing at a death is chargeable. It is, perhaps, less easily to be reconciled with the Capital Levy, which has in view a tax upon living persons at a particular date according to a valuation of their individual wealth at that date. The life tenant or the remainder man might feel that he had a strong claim not to suffer under a levy more than he would on a valuation of his own interest.

716. Questions of equity would undoubtedly arise, but they do not seem to us to differ essentially from those under the Estate Duty. We refer to them again in a section dealing with the equity of the levy proposals (*paras.* 854-7). All we need say here is that the suggestion put to us by the Board of Inland Revenue cannot, in our view, be ruled out on the score of unfairness to individuals. Indeed, we think it likely that it would prove less unfair than an attempt to value the separate interests. This being so, full weight can be allowed to the superiority of the method from the practical point of view, and we should favour its adoption in preference to any alternative that we have had before us.

717. The question of the method in which payment of the levy might be allowed gives rise to a number of difficulties. We consider them under a separate head (*para.* 749 *et seq.*); they do not appear to us to be insuperable. Other important factors bearing on practicability are the exemption limit and the rates at which the levy would be charged. We will discuss

these immediately. On the general question whether a levy could be effectively carried through we see no reason to differ from the Board of Inland Revenue. A Capital Levy would in any circumstances be a very difficult taxing operation, but, if the important assumption be made that it would receive a normal measure of assent and be collected under normal economic conditions (*Appendix* XXII., *para.* 5), it should, in our opinion, be feasible.

II.—SCALE, ETC., AND YIELD OF A LEVY : RESULTANT ANNUAL SAVING OF INTEREST.

718. *Yield to be aimed at.*—The Trades Union Congress and the Co-operative Congress considered that the yield to be aimed at should be at least £3,000 millions, the amount contemplated by the Labour Party in the proposal put forward by them in "Labour and the War Debt". (1922). Dr. Dalton regarded £2,000 millions as the minimum for which it would be worth while to impose a levy, while he doubted whether it would be practical politics to aim higher than £4,000 millions (*Ev.*, *p.* 492; *E. in C.*, 2). Professor Macgregor suggested that "in view of equities and administrative problems" £1,000 millions was "a reasonable sum for the present to afford" (*Ev.*, *Appendix* VIII, *para.* 5).

Before judging the yield to be sought, we think it necessary to consider what annual saving of interest might result from the raising of a given sum, and how far it would be offset by loss of annual revenue. This latter question depends largely on the scope of the levy, the exemption limit and the scheme of graduation.

719. *Scope and exemption limit.*—It was agreed by witnesses that any levy must be confined to individuals; this view we endorse. The majority thought it should extend to physical wealth only, as distinct from the "brain capital" of e.g. the professional man. On practical grounds we are of opinion that this would be necessary (*for the equitable aspect see paras.* 847-51).

720. Advocates of the levy were generally in favour of exempting fortunes up to £5,000, as in the Labour Party proposal. On the other side some opposition was expressed. The Association of British Chambers of Commerce regarded the £5,000 limit as too high on grounds of equity, and referred to a suggested exemption limit of £1,000 (*Ev.*, *p.* 577; *E. in C.*, 17-18). Mr. W. W. Paine thought £5,000 far too high, mainly for the same reasons, and looked on £1,000 as a maximum (*E. in C.*, 5-6). Those who defended the £5,000 limit did so on various grounds, largely practical. Mr. Alexander said that the £1,000 limit originally favoured by the Co-operative Congress had been found not to be practicable, which he interpreted in a political rather than a financial sense (Q. 7930-4). The Trades Union Congress suggested that the cost of collection of small

amounts would be extremely heavy and not worth while. Taking a point of principle, they said that the Labour Party had come to the view that the £1,000 limit would not sufficiently exclude the people who were working single-handed, often with a small capital (Q. 8301). Mr. Pethick-Lawrence accepted the £5,000 limit as a basis of discussion, since it appeared to be generally desired. He would still have preferred a levy with a lower exemption limit designed to pay off the whole debt, if the country would have accepted it (Q. 6371). Dr. Dalton agreed that he would be prepared to see the limit go down to £1,000, if it could be shown to be " economically advantageous, or rather not economically ruinous " (Q.6901-2).

721. Discussion of an exemption limit raises the whole question of the equitable distribution of taxation for the debt. We refer to this aspect in the section dealing with equity (*paras.* 852-3). Confining ourselves here to the question of practicability, we note that the Board of Inland Revenue state that the number of charges has an important bearing on this point; they estimate the number of individuals with £5,000 of capital and upwards as, approximately, 500,000, and the number with £2,500 and upwards as about 900,000; the number with £1,000 and upwards would, we understand, be something like 1,500,000. The rate of duty on the small fortunes could not be put high, and the cost of collection, as the Trades Union Congress point out, would be heavy. Moreover, as the Board of Inland Revenue explained in connection with the War Levy proposal, " an important consideration is that many of the very numerous persons in the lowest ranges of wealth are owners of small businesses, the valuation of which presents grave practical problems."

722. An exemption limit, wherever fixed, must raise difficulties of some kind, but it is certain that, as the exemption limit is lowered, these difficulties become greater in degree. The more the area of valuation and collection is enlarged, the less could the taxing authorities concentrate on securing equal treatment for individuals and preventing evasion; the less in fact could the administration of the levy approximate to the standard of efficiency normal in the taxation of this country. It is, indeed, the attainment of a certain degree of efficiency in this sense which gives us a standard of reference for judging of practicability—a term which would otherwise have no definite meaning; the fact that a limit lower than £5,000 would bring in classes of small shopkeepers, farmers, etc., where valuation is extremely difficult, makes the average degree of practicability much less over, say, the area of 900,000 persons involved by a limit of £2,500, than it would be over the area of 500,000 persons involved by a limit of £5,000. There are objections in principle to taking so high a limit as £5,000, but, however serious these may be, there would appear to be great practical advantages in its favour.

In view of these considerations, we assume an exemption limit of £5,000 for the purposes of our discussion of the levy; any inequity involved in exempting holders of property below this figure might possibly be counteracted by imposing on them a tax of a different nature. We have not, however, explored this question.

723. *Scale and yield.*—Steep graduation would be required in order to raise a very large sum; it is an essential feature of the Capital Levy as understood in this country. We give below the provisional scale suggested by the Labour Party in "Labour and the War Debt," and two other hypothetical scales on which we requested the Board of Inland Revenue to prepare estimates :—

"Slice" of Estate.	Scale I. Rate per cent. on slice.	Scale II. Rate per cent. on slice.	Scale III. Rate per cent. on slice.
First £5,000	Nil.	Nil.	Nil.
Next £1,000 (up to £6,000) ...	5	1	5
„ £2,000 („ £8,000) ...	10	2	5
„ £2,000 („ £10,000) ...	15	3	5
„ £5,000 („ £15,000) ...	20	4	10
„ £5,000 („ £20,000) ...	25	5	15
„ £10,000 („ £30,000) ...	30	7	20
„ £20,000 („ £50,000) ...	35	10	25
„ £50,000 („ £100,000) ...	40	15	30
„ £100,000 („ £200,000) ...	45	20	40
„ £300,000 („ £500,000) ...	50	25	50
„ £500,000 („ £1,000,000) ...	55	30	60
Remainder	60	35	70

724. The Board gave the following estimates of yield on the present basis :—

Scale I.—£2,500 millions.
Scale II.—£1,000 millions.
Scale III.—£2,000 millions.

These figures, they explain, were arrived at on an arithmetical basis "without making any allowance for evasion, defaults or other difficulties inherent in such taxation, and are, therefore, maximum figures, which might not be attained in actual fact if a Capital Levy were imposed." (*Appendix* XXIII, *para.* 5.)

725. The general opinion of witnesses who advocated a levy was that a yield in the neighbourhood of £3,000 millions should be aimed at, and that the scale should be regarded as subordinate to this yield rather than as determining it. One method of raising £3,000 millions would be to increase by one-fifth the rates of duty throughout Scale I.

726. *Annual Saving.*—It may be well to define what is understood by the "*annual* saving of interest" due to a levy. The term is ordinarily used as denoting the amount of interest which would be saved immediately by the redemption of a given

amount of debt. To regard this immediate saving as continuing to be realised year by year implies a twofold assumption :—

(i) that, after the levy, the yearly saving of interest through the Sinking Fund would continue exactly as if no levy had taken place; and

(ii) that, if there had been no levy, the rate of interest on the debt would have remained constant.

727. Even assuming the continuance of the same Sinking Fund after the levy, it will be noted that the annual saving due to the levy would not represent a clear *permanent* gain over the saving that would be effected under a Sinking Fund policy alone: for such a policy would eventually have wiped out the debt and the interest upon it.

As regards the rate of interest, it appears to be uncertain that, even in the years following close upon the levy, the immediate saving would be an absolute net gain, since, in the absence of a levy, conversions might have effected a saving in interest on part of the debt concerned. These, however, are considerations to which no positive figures can be attached, and, so long as they are recognised, we think there is practical justification for the usual broad way of measuring the annual saving in interest due to a levy. It may well be argued that what matters is not so much the precise saving ultimately to be effected, as the immediate Budget relief.

728. In dealing with the effect on the Budget it is, of course, essential to set against the saving of interest the annual loss of revenue—Income Tax, Super-tax and death duties—which would result from the reduced wealth of the levy payers.

Here again the *annual* loss of revenue is commonly measured by the immediate loss. This, too, can be justified, so long as it is realised that no account has been taken of any expansion or contraction of existing revenue that might have taken place in the absence of a levy.

The net relief to the Budget, i.e., the gross saving of debt interest minus the loss on existing taxes, may conveniently, if rather loosely, be referred to as the net saving of interest.

729.—(i) *The gross saving of interest.*—Even when the yield of a levy has been fixed, there are so many unknown factors that it is difficult to estimate the gross saving of interest which would result. It may, perhaps, be taken that a considerable part of the levy would be paid directly in Government stocks (*cf. para.* 750), and that, in view of the Government's right to redeem within the next few years, the tendency would be for the levy payer to offer stocks of the shorter dates. For a similar reason there would be a disposition on the part of the State itself to redeem those stocks out of the cash part of the levy. The immediate saving would in these circumstances be considerably higher than that which would result if the levy redeemed all kinds of debt proportionately. The Board of Inland Revenue, in the estimate which they provided, assumed the redeemed securities

to be all on a 5 per cent. basis. This gives a gross interest saving of—

£125,000,000 under Scale I.
£50,000,000 „ „ II.
£100,000,000 „ „ III.

The figures of saving might have to be considerably reduced if any part of the levy were used to repay Floating Debt or external debt.

730. The Budget relief could, of course, be increased, if it were decided to reduce the Sinking Fund provision. Mr. Pethick-Lawrence went so far as to say that, for purposes of comparison between our present position and that brought about by the levy, it was " evident that the Sinking Fund should be assumed to be at the same percentage of the outstanding debt in both cases " quite apart from the actual policy adopted in regard to the amount of the Sinking Fund. (*E. in C.*: 9.) On this basis the relief to the Budget from a levy raising £3,000 millions could be enlarged by nearly one-half of the Sinking Fund. It was pointed out, however, by more than one witness that a reduction of the Sinking Fund, by retarding the further programme of debt redemption, would modify the advantage of early repayment claimed for the levy.

731.—(ii) *The net relief to the Budget through the reduced interest charge.*—Dr. Dalton, in his " Capital Levy Explained " (1923), calculated that the net saving on a levy yielding £3,000 millions would be £70 millions (£142 millions gross, minus £72 millions loss in Income Tax, Super-tax and death duties). In common with some other witnesses, however, he stressed the view that only the Government Departments concerned were in a position to submit a reliable estimate.

732. The Board of Inland Revenue estimate that the loss in annual revenue (i.e., Income Tax, Super-tax and death duties), due to a levy, and the net saving in interest, would be as follows under each of the hypothetical scales :—

Loss in annual revenue.	*Net saving in interest.*
£	£
77,000,000*	48,000,000 under Scale I.
33,000,000	17,000,000 „ „ II.
66,000,000	34,000,000 „ „ III.

These figures assume static conditions and do not allow for possibilities such as those alluded to in paragraph 709 above.

It will be borne in mind that Scale I, according to the Board's estimate, would yield £2,500 millions; Scale II,

* This figure, based on recent statistics and taking current rates of tax, represents a loss of 62 per cent. of the gross annual saving. On the basis of rates of tax, etc. in 1921, Sir Josiah Stamp, who considered there was a *prima facie* indication that the Labour Party scale would not raise as much as the £3,000 millions predicated, concluded that from 64 to 70 per cent. of the gross annual saving would be required to make good direct future loss of annual revenue. (*Current Problems in Finance and Government*, XI.) Allowing for changes in the rates of taxation, the estimates are in close agreement.

£1,000 millions; and Scale III, £2,000 millions. If the rates of Scale I were increased by 20 per cent. throughout so as to yield £3,000 millions, the net saving in interest might approximate to £60 millions.

733. Although all the reactions of a levy would have to be known in order to determine its true financial results, the amount of the immediate net saving is obviously of great importance. It largely influenced the attitude of several witnesses. Mr. Pethick-Lawrence thought that a levy had to be on a considerable scale or not at all, and he regarded a net saving of £50 millions a year as a minimum. If a levy were watered down to a point bringing in less than this figure, he did not think it would be worth going to the trouble of imposing it. (Q. 6274.) Both Professor Pigou and Mr. Keynes, who in the period immediately following the War expressed themselves in favour of a levy, informed us that they had come to a different view largely owing to the realisation that the inroads on ordinary revenue would make the net saving very much smaller than they had at first anticipated. Dr. Dalton, while emphasizing the view that there were other solid advantages to be gained from a levy, said :— " Clearly, unless we can get some appreciable net saving it would not be worth while." (Q. 6995.) His first inclination would, however, be to adjust the scale so as to make the net saving larger. The Co-operative Congress alone maintained that a levy would be worth while, even if it were an exact anticipation of future revenue from Income Tax, Super-tax and death duties. In oral examination, however, Mr. Alexander expressed his personal opinion that there was, perhaps, a limit below which it would not be worth while to go. (Q. 8108.)

734. *Conclusions on scale and yield.*—The Board of Inland Revenue state that the scale of the levy would have an important bearing on the administrative task, and that Scale II, which they estimate to yield £1,000 millions, with a net saving of £17 millions interest, would present far less difficulty than Scales I and III. (*Appendix* XXII, *para.* 9.) Professor Macgregor, who favoured a levy yielding £1,000 millions, did so largely on account of administrative problems. (*Ev. Appendix* VIII, *paras.* 5-9.)

735. We recognise that a levy on this scale would be a less difficult and also a less disturbing operation than one designed to raise a larger sum. It would still, however, be a very big task, and the effect on the debt burden (capital and interest) would not appear to be commensurate. It is apparent that it would be far from satisfying the majority of levy advocates. It is probable that owners of wealth would suffer a more acute and better-founded fear of the levy being repeated, than if it were on a bigger scale. Indeed, Dr. Dalton suggested that it should be a condition of any pledge not to repeat a levy that the levy should be " of reasonably drastic dimensions." (*Ev. p.* 493; *E. in C.* 6.)

736. We conclude, then, at once, that a levy of £1,000 millions would not justify itself. We think that the levy having the largest claim on our consideration is one designed to effect a net annual saving of interest of something over £50 millions, and to raise a sum approximating as nearly as possible to £3,000 millions. This would involve a scale more severe than that of the Labour Party (Scale I). For the purpose of our discussion we need not bind ourselves, in detail, to any particular scale. If a levy were enacted, the exact steps in the graduation would no doubt receive expert consideration, but it is unlikely that the scale adopted would differ essentially from the Labour Party's in general character.

III.—THE LEVY AND THE PRICE LEVEL.

737. If prices fell without a compensating increase in production, and led, as would normally happen, to a reduction of profits and wages, the money yield of existing taxes at their present rates would also fall. While Government expenditure on current services would tend to shrink, expenditure for interest on the debt would not be affected in money terms at all. Therefore, the real annual burden of the interest charge would increase, and, similarly, repayment of debt at lower price levels than those prevailing when the money was borrowed would transfer to the debt holder a greater command over commodities than he transferred to the State at the time of lending. If, therefore, a heavy fall in prices is anticipated, there is a strong argument for repaying as much debt as possible before the fall occurs.

It is true that there would very likely be some set off. For, if the heavy fall in prices were followed by a drop in the general rate of interest, it might make valuable conversions of debt possible. In this aspect a levy might forfeit a material advantage, as regards the part of the debt which it redeemed. On the other hand, the levy might itself exert some favourable influence on the Government rate of borrowing (*cf. para.* 768).

738. From the statement handed in by the Treasury (*Appendix* XXV) showing the price levels, according to the *Statist* index number, at which the debt was raised, it appears that a little over two-thirds of the debt may be regarded as having been raised when prices were above the present level. (This approximation can only be rough, since the cash figures given are net borrowings, or net repayments, in the year.) The largest borrowings were in the years 1916-17 to 1918-19, when a net sum of £3,145 millions was raised, with an average price level (1913 being taken as the base year) of 170·0 in 1916-17, 212·3 in 1917-18, and 226·1 in 1918-19. These borrowings included the 5 per cent. War Loan and the bulk of the issues of National War Bonds, securities which have comparatively short lives, compulsory or optional.

739. At the time when the levy was first brought into prominence, the price level was, of course, much higher than at present. In 1919-20 and 1920-21 it was 261·1 and 270·6, respectively, or above the level at which borrowing in the three years preceding had taken place. The level for 1923-24 was 154·3, for 1924-25, 166·1 and for 1925-26, 155·1. (*cf. para.* 199.) The extent of the fall proves how strong was the case for a Capital Levy after the War, so far as it rested on the high price level then ruling. It is clear that in present circumstances the argument is no longer the same.

740. As might be expected, the evidence tendered on the question of the future price level was, for the most part, very indefinite.

Professor Scott, who dealt with it in some detail, guarded himself by saying that, as we were concerned with prices over a period of about a century, it was merely a question of making the best guess. He considered that the conditions of gold production and the probability of the economy of the use of gold for currency were the more relevant questions in relation to the metal, and the general technique of industry and commerce in reference to commodities. There seemed to be some grounds for a fairly confident expectation of a very considerable development of methods of production within a generation from now, with a consequent tendency towards greater plentifulness of commodities. Taking account of all factors, he thought that ultimately prices would be lower than the present level, but that the fall would be rather protracted and it would be some time before it became definitely established. The increased production of commodities was likely to be greater during, say, 1940-50 than the increase in the production of gold. His anticipation tended in the general direction that the maximum strain for interest on the debt had been already passed; that prices were likely to oscillate rather more in the next few years than in the immediate past; and that during that period a fall on balance was unlikely. After that it was possible that a considerable interval would elapse before the ultimate fall would establish itself, and finally, unless there was an almost unique combination of circumstances, the price level at the end of the 19th century was unlikely to be repeated. In view of the uncertainty of price movements, he considered that there was no special reason on this ground for an early repayment of a large amount of debt (*E. in C.*, 2).

Mr. Hobson did not anticipate any early change in the level. Mr. Paine also thought that, with wages at their present level, there would be no considerable reduction. The Association of British Chambers of Commerce held similar views. Dr. Dalton considered that the risk of a fall was an additional argument for a levy; no one could estimate the risk, but there could be no doubt that it existed. Mr. Pethick-Lawrence thought the question depended almost entirely on currency policy, and, until

that was decided, only baseless conjectures could be made. The Trades Union Congress attached little importance to any estimate in view of the scanty data. In their view, the case for debt repayment is, and must be, established upon the known facts of the case.

741. Mr. McKenna said that, if the course of history were any guide, prices were certain to rise over a considerable period of time, so that postponed repayment would benefit the debtor, in this case the nation (*Ev.*, *p.* 480; *E. in C.*, 10). Professor Pigou, however, pointed out that the appeal to history furnished no proof that the tendency to rise would continue, and added that adequate data for prophecy were lacking (*Ev.*, *p.* 436; *E. in C.*, 4).

The Federation of British Industries, who thought that the only fall in the price level likely to take place in the future would be a very gradual process caused by cheaper methods of production and new inventions, suggested that, with the return of this and other countries to a gold standard, the price level would in the future become a world price level. If and so far as there were control by a conference of the central banks of the world, indications seemed to point to a notable influence in favour of a rising rather than a falling level. The Federation added a reference to the growing body of opinion in favour of stability, and to the possibility of a compromise stabilising world prices at somewhere above the present level. " As far as can be judged, therefore, the probability seems to be that the future level of prices, if it differs at all from the present level, will be higher. Immediate heavy repayment of debt, therefore, which might be justified in circumstances when a rapid and substantial fall in prices was to be anticipated, would merely result in unnecessary sacrifice and effort, since the debt could be repaid more cheaply at a later date." (*Ev.*, *Appendix* VI).

742. It would be necessary to weigh other difficult economic questions, not covered by the evidence, in order to attempt any nice balance of probability as to the future trend of prices. We think, however, that the evidence is sufficient to indicate that present conditions do not point to any very strong or definite movement in general prices such as would be required to affect in any important degree the case for or against a levy. Much depends on the direction of banking policy in this country and also abroad, a most important matter, as indicated by the Federation of British Industries, but one which we have not been asked to examine.

743. We consider in a separate section (*para.* 786 *et seq.*) the possibility that a levy might itself induce deflation and a fall in the price level; if it did so, it would of course add to the annual burden of the unredeemed part of the debt.

IV.—THE QUESTION OF A GUARANTEE AGAINST REPETITION.

744. We have referred above (*para.* 735) to the fear that a Capital Levy might inspire of its being followed up by a second. All the economic effects of a levy would depend a great deal on psychological reactions. It would, therefore, be important that a Government introducing a levy should consider every means of making it as acceptable as possible to the taxpayer, and particularly to the trading community.

745. The general opinion of witnesses has been that a levy, unless it were accompanied by some kind of guarantee, would give rise in greater or less degree to the fear of repetition. Mr. Hobson was exceptional in not believing that owners of capital would feel any real apprehension, short of the emergency of another war (*Ev., Appendix* VII, *para.* 6).

746. Without exception, witnesses have agreed that it would be impossible under our constitution to give any absolutely secure and effective pledge that a levy would not be repeated. While, however, some witnesses have expressed the view that no guarantee could be convincing or effective, others have thought that a limited guarantee would serve the purpose. Dr. Dalton suggested that the present generation of politicians could pledge themselves against repetition and, if a levy of reasonably drastic dimensions were agreed upon, ought to do so (*Ev. p.* 493; *E. in C.*, 6). The Co-operative Congress suggested an assurance —participated in by all parties—that the levy was exceptional and would not be repeated within any conditions that could now be foreseen (*Ev., p.* 566, *E. in C.*, 17). Mr. Pethick-Lawrence also suggested a conditional assurance by those bringing in the levy (*E. in C.*, 13). The Trades Union Congress, who thought a guarantee should be given, were of opinion that the form suggested as possible by Sir Josiah Stamp in " Current Problems in Finance and Government " would in practice be accepted as effective by the taxpayer (*Ev., p.* 587, *E. in C.*, 10); the suggestion referred to is that every levy receipt might on the face of it contain a Government undertaking that the " corpus of wealth " brought under the tax represented by the receipt is franked for a minimum period of 25 years from any tax of a similar kind.

747. We agree that an absolute guarantee against the repetition of a levy would be constitutionally impossible in this country. Even were it otherwise, we should question the wisdom of an unqualified pledge. Mr. McKenna, while strongly opposed to a levy, argued that, if it were a beneficial proceeding, there was no reason why it should not be repeated, and in these circumstances a guarantee would be a self-denying ordinance (Q. 6620). Up to a point we agree. The success of a levy would, within limits, be a consideration in favour of repeating it, though only after some interval of time; again, even if a levy were found not to be

a success in given conditions, it does not follow that in widely different conditions it might not be a salutary or even a necessary operation. Further, the administration of a second levy might well gain from the experience of the first.

748. These are valid reasons against a State attempting to bind itself absolutely, on bringing in a levy, not to impose a second. At the same time the question whether a levy proved to be a " beneficial proceeding " or not might, we think, depend in no small degree on the presence or absence of a guarantee limited in some way. The kind of limitation would need to be carefully considered. If the guarantee extended only to such wealth as might be subjected to the first levy, it would do little or nothing to reassure those individuals whom the first levy caught at an early stage in their acquisition of wealth. Indeed it might accentuate the fears of the trader who was just beginning to build up a business, and who was therefore only contributing lightly to the first levy—say £50 or £60 on a capital of £6,000—or who, it might be, was altogether immune. From this point of view we consider that any guarantee ought to be wide in its scope, applying to all capital wealth; on the other hand it ought to be limited in time. It would require to be made clear that the levy was emergency legislation, and that it would not be repeated at least for some years, unless there were any serious and unforeseen crisis. We think such an assurance would be of value and would help to allay apprehensions. It would be too sanguine to expect that it would altogether remove them.

V.—METHODS OF PAYMENT; EFFECT ON VALUE OF SECURITIES.

749. Little evidence has been offered regarding the extent to which it is likely that a levy would be paid in each of the possible forms—cash, Government securities, other trustee stocks, &c. Witnesses who discussed the question were in general agreement that little would be paid in cash. Dr. Dalton anticipated that " the great bulk of the levy " and the Trades Union Congress " a very substantial part " would be paid in War Loans and other Stock Exchange securities, and the latter supposed that payment in real property would not be accepted (*Ev. p.* 589 : *E. in C.* 27). Mr. Paine, on the assumption that the levy had to be paid either in cash, War Loan or securities of the trustee class, thought a fair estimate would be that one-half would be payable in War Loan and securities : an extension of securities approved for acceptance beyond the trustee class would, of course, reduce the cash payment (*E. in C.* 40).

750. The Board of Inland Revenue explained to us that the amount of British Government securities that might be tendered in payment of a levy could only be matter for conjecture.

They gave us a rough estimate as follows :—

	Approximate yield of levy.	*Maximum percentage that might be payable in British Government Securities.*
	£ *millions.*	%
Scale I	2,500	50
Scale II	1,000	75
Scale III	2,000	55

The percentages were based on the assumption that the holdings of British Government securities in the various ranges of capital wealth that would be liable to a levy bear the same proportion to the total capital in those ranges as is shown in the statistics of capital values paying Estate Duty; it was also assumed that the whole of the securities in question (whether free or settled) would be available for payment, and that they would be accepted at their market valuation.

751. Since there is no definite knowledge as to what securities would be accepted by the Government in payment of a levy, and since much depends upon the precise arrangements made for payment, the views expressed by witnesses regarding the effect of a levy on the sale of securities were frequently conditional.

752. Sir Felix Schuster believed that securities would become unsaleable. Holders of debt who were paid off would to a great extent re-invest abroad. In fact, according to all experience, such a flight of capital would occur long before the levy could take effect (*Ev. p.* 559; *E. in C.* 11).

Mr. McKenna considered that in practice a levy would not lead to the sale of securities, because it would be found that the levy could only be made if securities were accepted by the Government in payment of the levy. If this were not done, the offers for sale would be so extensive as to swamp the market (*Ev., p.* 481; *E. in C.* 24).

Most of the other witnesses contemplated that the list of approved securities would at least include all trustee securities; their views as to disturbance in values were related to the balance when non-acceptable stocks had to be sold and cash tendered (except so far as payments were allowed by instalments). As regards this balance it was pointed out by Mr. Pethick-Lawrence, whose views were shared by other witnesses in favour of the levy, that, where sales actually occurred, there would be someone anxious to buy corresponding to every one anxious to sell, because no one, not even the State, was out to obtain or retain money as such. There might, however, be small changes in price as between different securities, and these changes would be in favour of State loans and other trustee investments. (*E. in C.*: 22.)

753. As indicated by Professor Scott (*E. in C.* : 19), the difficulty is that, at the first stage, there would be the danger of a vicious circle. So far as the Government accepted stocks other than its own loans, it could not cancel debt until they had been disposed of, and funds would not be available in the market for their purchase until the proceeds of Government purchases of debt were liberated. Further, those estates which did not include approved securities would have either to borrow from their banks, or to sell other securities, before the Government had disbursed money in debt redemption. Moreover, it was probable that, even when the Government redeemed debt, it would largely be by the purchase of trust holdings, the proceeds of which could only be reinvested in trustee securities. Therefore, Professor Scott concluded, there would be a marked tendency for all non-acceptable stocks (and in particular ordinary shares) to fall in price. In other words, although there might be an equivalence between the amount of supply and amount of demand, there would be a difference between supply and demand both (*a*) in time and (*b*) in quality.

754. These views were shared by other witnesses in varying degrees, but Professor Pigou thought that if the position were properly handled, no general slump of values should occur, although, even then, it might well be that the relative values of different sorts of securities would be more or less seriously disturbed. (*Ev. p.* 437; *E. in C.* : 14). Mr. Paine thought the demand for investments by paid-off holders of debt would do something, but not very much, to meet the difficulty of the levy payer in selling securities which the Government refused to accept; people who had held War Loan would not be disposed to invest in such a class of security. (*E. in C.* : 32.) The Trades Union Congress thought that, if there were a tendency to a fall in prices owing to the bulk of sales taking place before the demand for new securities was felt, this would be quickly checked by purchases in anticipation of the demands which were known to be coming; thus the banks themselves would increase their purchases of investments and so help to counteract the tendency to a fall. (*Ev. p.* 588; *E. in C.* : 18.)

755. Interesting proposals were made by Lord Arnold in the House of Commons in April, 1918, and in the "Economic Journal" of June, 1918. He outlined four principal methods by which "the whole of a levy could be paid or met with little or no realisation or selling of securities or property at all."

In brief his proposals were :—

(i) Direct surrender of war stocks at a price fixed to give some advantage to the holders.

(ii) Direct transfer of "approved" securities (in which he proposed to include debentures and preference shares of good companies). The Government would have no need to realise these, but would offer to exchange them with war

stock holders under voluntary and agreed arrangements, some slight advantage in price being given to the stock holders as an inducement to make the exchange.

(iii) Payments by instalments out of income, or by means of credit facilities for certain classes arranged by the Government with the banks. These borrowers would give security by mortgage or otherwise, and the banks would be guaranteed against loss by the Government. Most of the accommodation could be given in war stocks held by the banks.

(iv) Direct payments in cash, though not very much would be done in this way.

Lord Arnold suggested that certain persons would still prefer to sell securities, but that the total amount of transactions would be small; he also suggested that a year should be allowed for payment of the levy. As there would be buyers out of the proceeds of redeemed debt, he concluded that a collapse of prices was out of the question.

756. For our own estimate of the prospects we may conveniently take four heads:—

(i) The general disturbance to the investment market of a large-scale financial operation such as the levy;

(ii) panic sales at the time a levy was first proposed, without regard to, or in advance of, the arrangements to be made for payment;

(iii) sales by the Government of approved securities accepted in payment of the levy;

(iv) sales of non-approved securities by individuals to provide means of paying the levy.

757. *General disturbance.*—It seems possible that the knowledge of an impending levy, and the uncertainty of its effect both on values and credit facilities, might restrict all speculative transactions. If it is true that there are generally more " bulls " than " bears," this would tend to depress prices; the classes of security more particularly affected would be those which appeared unlikely to be included in an " approved " list, and which would therefore be regarded as liable to forced realisation for payment of a levy.

There would also tend to be a lag in the normal investment demand arising from new savings, to the extent that those savings were kept in reserve towards payment of a levy. Day-to-day transactions in changing investments might also tend to be deferred until the outlook was clearer, particularly in the lower grade securities; though, on balance, such transactions do not, perhaps, affect prices as a whole very much, any inclination on the part of investors to favour fixed interest securities would tend to depress the non-acceptable stocks.

758. *Panic sales.*—The possibility of apprehension—reasoned or unreasoned—of the effects of a levy bears on the whole question of its practicability, and is not peculiar to this question.

As we have emphasised (*para.* 709), some measure of general assent and good will would be necessary for its practical working. If this were forthcoming, there would be no likelihood of panic sales to any great extent.

759. *Government sales of accepted securities.*—This is so much a matter under the control of the Government that it seems not unreasonable to assume that arrangements could be made to avoid undue pressure on prices. Lord Arnold's proposals for the exchange of securities with war stock holders seem to be practicable up to a point, although the operation would be by no means simple. But, unless the Government were to issue revised lists of exchange prices, until they induced the necessary demand in every case, they could not avoid sales altogether. Moreover, the knowledge that such securities were held only temporarily, and for disposal when occasion offered, would no doubt have its normal effect of depressing market quotations.

760. *Sales by individuals of non-approved securities.*—Such sales to provide for levy payment would obviously depend for their magnitude partly on the area of approved securities and partly on such considerations as the period allowed for payment, the scope of payment by instalments, etc. In a certain number of the smaller cases, where there was also earned income, an appreciable part of the levy would no doubt be met out of normal or additional savings, or out of deposits, etc. In the case of moderate fortunes up to, say, £50,000 it would appear possible in general to meet a high proportion of the levy out of Government securities and approved securities. But Estate Duty figures suggest that the proportion payable in this way would very materially decrease in the larger estates; for the percentage of the total estate invested in Government securities remains fairly constant, while the percentage to be taken by the levy rises steeply. So far as realisations were necessary, there would be the difficulties referred to in paragraphs 753-4 arising from the difference between supply and demand (i) in time and (ii) in quality.

761. The time difficulty could no doubt be overcome to some extent, if the Government were to purchase Government stocks in advance of levy payments by means of temporary credits. This would presumably lead to some temporary inflation. The extent to which banking accommodation was given to levy payers themselves in order to obviate immediate realisation might also mitigate the possibility of a slump.

762. Differences between the character of supply and demand could not apparently be overcome by any Government action. The whole trend of the demand for investments would depend on the needs and inclinations of the repaid debt holder. In

effect, if only one-third of the levy were paid in War Loan, holders of debt to the extent of two-thirds of the levy would be in search of investments.

While the character of the demand cannot be altogether foreseen, it is certain that a large proportion held for trusts, etc., would seek reinvestment in the narrowed area of gilt-edged securities. There is a strong presumption that trustee and prior charge stocks would tend to appreciate at the expense of some fall in ordinary stocks (*cf. paras.* 767-8).

763. *Conclusion as to effect on security values.*—We assume that all trustee securities would be accepted in payment, and possibly certain company debentures, although we see great difficulty in the Government discriminating between one business and another. The machinery for payment of the levy and redemption of War Loan stock would require to be very carefully devised and handled. In order to allay apprehension it would seem necessary, on the first announcement of a levy, to make known in the clearest possible form the steps by which it was proposed to facilitate payment. It would be exceedingly difficult to do this effectively, if the levy proposal had to be carried in the face of strong opposition in the House of Commons, or if there were active propaganda in the country and in the Press. The task would be immeasurably easier, if the levy were to meet with a fair degree of acceptance from all parties.

764. If the first shock of the levy were successfully broken, we think it would be possible to carry out the whole operation without any serious slump in values. We assume that payment by instalments would be allowed in suitable cases, (*cf. para.* 801), and that the banks would do all in their power to assist levy payers who could offer reasonable security.* But there would still be some maladjustment between the kinds of stock which would be up for sale, and those for which there would be a demand; on this account some depression of ordinary stocks could hardly be avoided, although, if the general atmosphere were favourable, they might not take long to recover.

765. The difficulties we have noticed in this section bring out very clearly the experimental nature of a levy, which renders any certain forecast of its results impossible. Success in the machinery of payment would be vital, for, if anything like a panic took firm hold on the market, the ill effects would radiate in all directions, and trade and employment would quickly suffer. Once again, everything would turn on the way in which the proposals were received by the taxpayer.

* This would hardly be consistent with the increased purchase of investments by the banks as suggested by the Trades Union Congress (*cf. para.* 754).

VI.—EFFECT ON GOVERNMENT RATE OF BORROWING.

766. Mr. Paine and the Association of British Chambers of Commerce anticipated no market effect on the terms on which the Government could raise loans. Professor Pigou thought that the wiping out of a large part of the debt would improve the credit of the Government, but that this would not have much effect as things are, though of substantial advantage in the event of another great war. (*Ev. p.* 437; *E. in C.*, 13.) The Trades Union Congress anticipated a fall in the yield of gilt-edged stocks owing to the reduction in their volume. (*Ev. p.* 588; *E. in C.*, 17.)

Professor Macgregor thought the influences on credit would show themselves in any future financial emergency; criticism would then be made, if the debt problem had not been firmly handled. But on this ground there was nothing to choose between a levy and an equally effective adjustment of taxation. (*Ev. Appendix* VIII, *para.* 19.)

767. The borrowing rate depends in the main upon the supply of and demand for capital, and the relative security, marketability, etc., of Government stocks as compared with other securities. As a single factor, the reduction of the area of gilt-edged securities effected by a levy would tend to lower the rates at which the Government could borrow. This tendency would be assisted by the demand of the repaid debt holder for investments of a similar character. (*cf. para.* 762.)

768. It is possible that the tendency would be checked by some increase in the amount of gilt-edged securities outside the debt. Mr. Keynes (giving evidence in May, 1925) expressed the belief " that for the last year and a half, say, the new home trustee securities available, minus the debt paid off, are far short of the natural accumulations seeking an outlet of that kind." (Q. 7563.) The occasion of a levy might seem an opportune occasion for such borrowings, particularly by overseas borrowers (if no steps were taken to prevent this) and by municipalities, and thus to some extent counteract the stimulus to prices in the gilt-edged market. Some overflow might also go into mortgages on real property, well secured debentures, etc. On the whole, however, it seems likely that a large operation of debt repayment would result in some immediate benefit to the prices of Government securities, with perhaps a tendency also for the general rate of interest to fall, though no permanent benefit would seem to be assured.

This assumes, of course, that there would be no general slump affecting all securities.

VII.—THE LEVY AND NATIONAL CREDIT ABROAD.

769. The ultimate effect of a levy on the attitude of foreign countries would be bound up with the whole complex of reactions at home. The views of witnesses on this question were, therefore, determined in the main by their estimate of the general home effects.

Professor Scott suggested that the lapse of time since the War made the prospects more unfavourable. He thought that, if a levy had been made within two years of the Armistice, it would have had some small chance of being accepted as part of the war disorganisation; now it was to be feared that it would be regarded as a proof that the country was unable to adapt itself to the new conditions (*E. in C.*, 17). This is possible; on the other hand, if a levy had been imposed soon after the War, it might have been taken by the foreigner to indicate a situation so desperate as to call for extreme remedies. The danger of such a view would be less now, assuming a levy to be imposed with anything like general assent.

But a levy is a form of tax viewed with suspicion in many countries, and it would be apt to be regarded—the more so on account of its departure from British financial methods—as an indication of a state of necessity which had no existence in fact; an adverse reaction upon the country's credit must to that extent be anticipated. The position won since the War by steady and accepted methods of finance would, it is thought, be greatly imperilled, and confidence could be restored only by a high degree of success in the working of the scheme.

770. Whatever the final effect might be, the first announcement of a levy would be likely to cause disturbance. Mr. Paine anticipated that, although the levy was intended to fall only on nationals of this country, it would cause serious misgivings on the part of foreign investors and depositors, who, at the first intimation of a levy being likely and before its terms were finally settled, would probably remove their investments and deposits, in the fear that they might in some way be affected (*E. in C.*, 27). We think there is substance in this argument. The Government would no doubt make their intentions as clear as possible, but, even if everything were done to reassure the foreigner, we do not think that the danger of money being removed could be wholly averted.

VIII.—EFFECT OF A LEVY ON BANK ADVANCES.

771. In considering this question, we have to deal with a tax which avowedly would fall upon, and be paid out of, capital (in the sense in which that term is usually employed by the individual in regard to accumulated wealth) except, perhaps, in certain cases where special provision might be made for payment by instalments. Individual wealth, as commonly understood

(not, of course, real wealth in the economic sense) would therefore be reduced, and it is frequently asserted that a huge deflation or restriction of credit would result.

772. From a banking point of view, the purely automatic results of debt repayment, whether of large or small dimensions, are essentially the same, although, where the repayment is large, there is presumably a greater likelihood of bank holdings (particularly of short-term debt) being repaid. Such an operation as a Capital Levy might set up many important influences affecting the readiness and ability of the banks to grant credit. These are, however, distinct from the automatic results which we now mean to consider.

773. The immediate effect of the levy would be to deprive the taxpayer of a part of his resources, and to replace the War Loan of the repaid debt holder with cash. In the course of the transaction a loan instrument would disappear. It would, of course, frequently happen that the transaction would be short circuited by the tender of Government stocks direct by a taxpayer who was also a debt holder. It is in this case that the effect upon credit is most easily seen.

774. Important evidence in support of the view that there would be a great restriction of credit was given by Mr. Paine, who prefaced his argument by pointing out that, to a large extent, subscriptions to War Loans had diverted money from the normal uses of capital—from the creation of new wealth—to almost wholly unproductive purposes. In consideration of this transfer the State had given the individual an obligation which would replace his capital and enable him to carry on his business. He suggested that by this means a new fund of capital had been brought into play, and he argued that the people who held War Loan in place of their diverted real capital, really held, from their point of view, capital. He agreed, however, that the State as a community was no richer. But by the loss of these instruments of credit under a Capital Levy the citizens' capital was reduced by £3,000,000,000, and he thought, therefore, that there was much more involved in the levy than the mere question of disturbance caused by the transfer of £3,000,000,000 from one set of pockets to another (Q. 5218). It was, he stated, the practice of banks to assess the credit which might be granted to customers in the light of their known capital (but without the actual deposit of collateral to the amount which would otherwise be required), and the reassessment which would necessarily follow a levy would entail a reduction of their power to obtain credit (Q. 5236).

775. As an example, Mr. Paine quoted the case of a cotton merchant, known to be worth £100,000, who desired a credit of £300,000, i.e., three times the amount of his capital, to import cotton. It was granted readily, against the documents, because of the margin provided by his capital. In the course of a year the transaction might be repeated three times and if,

under a levy, £30,000 was taken from the merchant, his credit for the purpose of his business would be reduced by £270,000 (Q. 5238). Mr. Paine added that he had tried to obtain statistics of the number of private firms engaged in importing staple commodities, and their average capital. While he could not get this information, he said he was generally told that to put the number of firms at 500, with an average capital of £50,000, would be an underestimate. Even on that basis, in the light of the example he had quoted, he anticipated an enormous restriction of credit (Q. 5240).

776. In the course of his examination Mr. Paine agreed that the restriction of credit, which might follow a levy, was confined to the reduction of securities in the hands of levy papers only, and did not extend to limited companies (Q. 5222). He hazarded the conjecture that about £1,000,000,000 out of a £3,000,000,000 levy would represent capital which might be used from time to time for credit facilities (Q. 5242).

777. The example quoted by Mr. Paine was, presumably, that of a merchant borrowing up to the maximum justified by his wealth, whose capacity to borrow would be reduced by the levy. While the advance was made against documents, his known capital was relied upon as the margin for the loan, since it was sufficient to cover fluctuations in the price of cotton. The more general case, and the case usually quoted, is that of a borrower who is actually required to deposit security to an amount sufficient to provide an adequate margin. This aspect was developed by the Federation of British Industries (*E. in C.*, 35 *et seq.*). Mr. Paine's illustration is of importance in showing that, even if the amount of actual collateral deposited by all borrowers were known, it would not give a complete measure of the individual wealth which figures as a basis of credit.

778. It may be convenient at this stage to attempt some definition of the area of a possible restriction of credit. In the first place, since public companies would not fall within the ambit of the levy, it is obvious that they would suffer no immediate disability in their power to claim credit, although their powers of expansion might be affected in other ways. In the second place, so far as the levy were paid in cash, or in securities which had not been pledged as security for advances or taken into account in the assessment of eligibility for credit, no difference in the volume of credit need result. It seems, therefore, that the range of direct restriction would be limited to cases in which either securities had been deposited as collateral, or known wealth had been taken as a basis of credit, to such an extent as would be affected by the levy payment. On the other hand, so far as a restriction operated to reduce a particular trader's activities, there might be a tendency for other traders less affected by the levy to enlarge their business and to require additional credit facilities.

779. We think it would be fair to assume that the great majority of private businesses of any magnitude do not trade up to the full extent of the credit which could be obtained on the securities and property held by their owners. This proposition can be tested in the light of evidence relating to two years given by the Board of Inland Revenue; evidence relating to 1919 was placed before the Select Committee on War Wealth, and evidence, giving comparative figures for 1919 and 1923, has been placed before ourselves. On the earlier occasion the Board took a test sample of the trading accounts of 310 private concerns engaged in manufacturing industries and wholesale distribution for a trade year ending within 1919. On the later occasion they made a similar examination of accounts ending within 1923, which embraced those of the 310 original concerns —216 in number—for which comparable figures were available.

780. The detailed results of the earlier investigation are to be found in the Appendices to the Report of the Select Committee (*H.C.* 102 *of* 1920, *p.* 292). They may be taken as sufficiently represented by the figures for 1919 comprised in the note by the Board of Inland Revenue which we print as Appendix XIX. As the figures for the two years 1919 and 1923 point to the same broad conclusion, we deal here with the later year only.

781. The Board's note shows that at the end of the 1923 trading year 61 per cent. of the 216 concerns had a credit balance at the bank, the credits aggregating £1·75 millions. In addition, investments totalled £1·93 millions and land and buildings £·79 millions. The total capital invested was £8·92 millions. The estimated private resources of the individual proprietors, 270 in number, were £10·02 millions.

782. The remaining 39 per cent. of the concerns showed debts to their bankers of £2·46 millions, but the total business assets, less all liabilities except the overdrafts, were £6·82 millions, including investments in stocks, shares and securities £1·71 millions, and land and buildings £·6 millions. The estimated private resources of the proprietors, 184 in number, were £4·39 millions.

783. The whole investigation of the 216 concerns, owned by 454 individuals, indicates that, out of total resources of over £27½ millions, business assets represented 48 per cent., or only a little over £13 millions.*

It must be noted that the sample does not include concerns dealing in produce and raw material, such as those which were especially in Mr. Paine's mind. It cannot therefore claim to be representative of this important section of big business. As regards the field of manufacture and distribution, we understand from the Board of Inland Revenue that they regard the

* Further evidence as to the large proportion of non-trade assets in the hands of private business proprietors is to be found in the Board of Inland Revenue's Note on Estate Duty and Private Businesses (Appendix XX) to which we refer again in paragraph 796.

sample as fully representative in the sense that, while the exact relations between business and private assets cannot be assumed to measure very closely the average proportions over the whole field, reliance can be placed on its broad result.

784. It seems safe to conclude that, in the case of private trading concerns (including private limited companies), the assets which proprietors could pledge for bank advances are, in the aggregate, far in excess of those actually so employed. The payment of a levy would definitely transfer a part of these assets to the State, but, in so far as the remaining assets were of adequate amount and suitability for the support of the existing amount of credit, no automatic restriction need result. The Inland Revenue figures lend no support to the view that a large restriction would follow a levy; individual cases would no doubt be affected, but, if provision were made for payment by instalments over a period of years where assets were locked up in business, it would seem possible to confine the total automatic restriction to reasonably small dimensions. This is not to say that the harm done could be judged simply by the quantitative restriction of advances. The effect on particular firms, and especially on those engaged in the import of raw material, might well be of considerable importance to the country's trade.

785. In the same connection we have examined the figures of banking statistics published in the *Economist* in their annual banking supplement.

The total advances and discounts aggregated as at the 31st December, 1925, for banks in Great Britain are given as £1,321 millions, and, after deducting the figure given for discounts in England (£227 millions) and a similar proportion for Scotland, it would appear that the total of advances throughout Great Britain may be put at approximately £1,070 millions. We have no means of dividing this figure amongst advances of different classes, but we believe that it is generally accepted that joint stock companies are relatively larger borrowers than private businesses. It may, perhaps, be assumed that the proportion of advances to joint stock companies and to private businesses carried on by individuals and firms will bear some relation to the profits assessed to Income Tax (Schedule D), though tending to overstate the proportion for the latter. For the year 1911-12 this proportion was about 60 to 40, and we see no reason to anticipate that it has changed in favour of the private businesses. On the basis of this proportion, the total advances to private enterprise would at a maximum be £430,000,000, but in fact, this figure would have to be reduced by a proportion of advances granted for non-trading purposes and for loans to persons below the exemption limit of the levy. Although these figures can give only general guidance, they seem quite sufficient to refute the suggestion that a Capital Levy raising £3,000,000,000 would involve a deflation of credit to an amount anywhere approaching that sum, even if the levy had

grave psychological reactions. The automatic restriction of credit physically due to a levy would, it appears, be on a moderate scale.

786. *Possible deflation or inflation.*—In the foregoing paragraphs we have more or less isolated the automatic effects of a large repayment of debt upon the existing volume of advances. In considering the wider question whether such a measure as the Capital Levy would lead to deflation or inflation, many other considerations have to be introduced.

787. Thus it is possible, as we have seen, that a levy would lead to a fall in general security values; if it did so, it would reduce the margin existing on present collateral, and the necessity for depositing additional collateral or for reducing advances would extend beyond the levy payers to joint stock companies. However, even with such a general tendency, there might be a counteracting influence; the prospective narrowing of the area of gilt-edged securities, combined with the special demand of repaid debt holders, might lead to an appreciation of the prices of those securities, which, after all, probably form the bulk of those deposited as collateral.

788. The effects of a levy on bank advances, like the effects in so many other directions, largely depend on the way in which the levy might be received. If it were looked upon with suspicion and with general apprehension of adverse results on trade, then it is to be anticipated that the banks would not be in a position to recreate deposits by advances to traders, since the demand would not exist. There would be a general tendency to reduce stocks and to throw them on the market at some sacrifice in price, and this tendency would, perhaps, be accentuated in the individual cases of levy payers using their resources up to the hilt for trading purposes, even though given the option of paying by instalments. Once started, such an influence might involve credit restriction to a very marked extent.

789. A further point to notice is that any Government contemplating a levy would doubtless take such steps as might be possible to facilitate the granting of credits to those levy payers whose property was in a form not acceptable in payment of the levy, and who would, if a forced sale were necessary, undoubtedly receive a low value. Such an increase of credit would, in itself, tend towards inflation, and Mr. Keynes thought that "the tendency to borrow would be incomparably stronger than the tendency to hoard, and that consequently the net effect would be inflationary rather than deflationary." (Q. 7620.) However, as Professor Scott remarked, "to the extent that banks are lending money temporarily to people to pay taxes they will not have that money available to finance trade." (Q. 8594.) A mere transfer of credit from people who want it for trade to people who want it to pay taxes would apparently induce deflation. The position was summed up by Lord Bradbury as

follows: "The operation of collecting the levy and the liquidation necessary to enable it to be paid would, while the process was going on, involve a considerable absorption of banking credit, which, in the absence of special action by the Bank of England, would lead to the calling in of bank loans to industry and to price deflation as a consequence. This could, however, and ought to be, counteracted by *ad hoc* creation of credit by the Bank of England." (*E. in C.*: 34.)

790. The position appears to be one of much uncertainty, but we think it likely that general tendencies would conduce to considerable deflation. Action to correct this would be possible and necessary, but it is difficult to see how the force of the corrective could be so nicely judged and controlled as to maintain equilibrium. We note that Mr. McKenna, who did not regard deflation as a necessary consequence of a levy, thought it more probable that the Bank of England would make additional loans, which would involve inflation. (*Ev. p.* 481; *E. in C.*: 25.)

We cannot agree with the Federation of British Industries that "the principal dangers to be anticipated from a Capital Levy relate to its deflationary aspects" (*Ev. Appendix* VI). We do, however, anticipate considerable uncertainty and disturbance.

IX.—THE LEVY AND PRIVATE BUSINESSES.

791. It is contemplated that the levy, being designed as a tax on individual owners of wealth, would not extend to public companies. The disturbance that might be suffered by those companies would be due to general considerations dealt with in other sections, e.g., the effects of a levy on security values and on the supply of savings.

792. The case of private concerns—firms and private companies—and also of public companies where the ordinary shares are in few hands, calls for separate examination. Here it is evident that a levy would in some cases cause direct disturbance, since, in falling upon the individual proprietors, it might compel the withdrawal of some part of the business resources. Mr. Paine expressed the opinion that the effects of a levy on private businesses would be very prejudicial to trade (*E. in C.*, 41). The extent of the harm would depend mainly on the proportion of the individual's wealth that might be invested in the business. Mr. Paine suggested that, while some people prefer to invest their savings outside their own concerns, the big businesses are made by putting back into them every sixpence that can be earned—"It is the principle that has been adopted with great success by men like Lord Leverhulme, Henry Ford and others" (Q. 5242).

793. The Trades Union Congress and Mr. Pethick-Lawrence argued that difficulty would only arise to a very limited extent. They referred in this connection to statistical evidence put in

by the Board of Inland Revenue to the Select Committee on War Wealth in 1920 (H.C. 102 of 1920, p. 289, *et seq.*). Part of that evidence was based on an examination of the accounts for 1919 of 310 private business concerns engaged in manufacturing industries and wholesale distribution. It was found that 63 per cent. of these concerns had no bank overdraft at the date of their last balance sheets : less than 40 per cent. of the total resources of the proprietors was invested in business assets.

794. We have already referred to these statistics and to the results of a further investigation by the Board, giving comparative figures for 1923 relating to 216 of the original 310 businesses (*cf. para.* 780 *et seq*). The Board's note (*Appendix* XIX) shows a remarkable similarity between the figures for the two years, considering the intervening depression. Of the 216 concerns, 63 per cent. had a credit balance at the bank at the end of the 1919 trading year, and 37 per cent. a debit balance. At the end of the 1923 trading year 61 per cent. had a credit balance and 39 per cent. a debit (*para.* 4). "The aggregate capital resources (business and private) amounted to over £25½ millions in 1919 and to over £27½ millions in 1923. Of these totals, the business assets comprised 54 per cent. in 1919 and 48 per cent. in 1923" (*para.* 12).

795. Sir Richard Hopkins, in commenting on the figures, pointed out, as regards concerns which were in debit both in 1919 and in 1923, that the amount of the indebtedness had increased (as shown at the end of para. 6 of the Board's note). With reference to the continued prosperity of many of the concerns, he observed that the trade depression had fallen with particular severity on the heavy trades—coal, steel, iron, &c.—which were very largely conducted by public companies. Thus the figures for the private concerns covered by the investigation probably reflected a greater degree of prosperity in 1923 than the average (Q. 9120). As regards the division between business assets and private assets, the Board's note indicated that, broadly speaking, the same ratio was maintained (Q. 9122).

796. It must be remembered that the samples taken by the Board are not representative for traders importing produce and raw material (*cf. paras.* 783-4). However, the general inference to be drawn is that the non-trade assets of the individual would in a majority of cases be sufficient to meet his liability under the levy. Further evidence in the same direction is provided by the Board of Inland Revenue's Note on Estate Duty and Private Businesses (*Appendix* XX). This note was founded on an analysis of 373 estates of a net capital value over £10,000 and including trade assets which came before the Board in the first quarter of 1922. We noted, in dealing with the Estate Duty, that when the estate debts were apportioned evenly over all the assets, only 0·8 per cent. of the 373 estates lacked sufficient private assets to meet the duty on the whole estate;

even when the whole of the debts were treated as a charge on the private assets, only 3·2 per cent. of the estates were in that position of difficulty (*cf. paras.* 502-3).

797. The Estate Duty scale, which has been somewhat increased since 1921-22, is much less severe than the scale of the Capital Levy provisionally suggested by the Labour Party. If the 373 estates had been charged according to the rates of the levy, there would have been a higher percentage of cases where the private assets would not have been enough to meet the whole payment; assuming an even apportionment of the estate debts, such cases would have been 3·2 per cent. of the whole; they would have been 7 per cent. on the less favourable hypothesis.

798. The percentages we have just given can only be used with great caution. Estates passing on death cannot be taken as representative of the estates of the living of all ages. A number of the persons dying at the more advanced ages will previously have retired from some or all of their business interests and transferred their capital elsewhere. The younger owners of business wealth liable to a levy would, as a rule, have a comparatively small proportion of their total wealth invested outside. Thus, in estates of the living, a higher percentage would be unable to meet the levy charge out of private assets. We should be disposed to think the difference considerable, but another note by the Board of Inland Revenue—an analysis showing the proportions of earned and investment income in the income of Super-tax payers according to age-groups (*Appendix* XV)—is evidence against putting it too high.

799. It is admitted on all hands that individual cases of difficulty and hardship would arise. The two most important questions are whether such cases would be numerous, and whether the concerns affected would on the whole be of such a quality as to make them exceptionally valuable to the country's trade. We have virtually answered the first question; it appears that relatively the number of cases would not be very great. The qualitative aspect is uncertain; but it is likely that not a few of the concerns in which the proprietors had sunk the whole of their wealth would be particularly progressive.

800. It may be said that such concerns could replace their lost capital by borrowing. This, however, would only be a very partial solution. The tendency is for loan capital to flow to the large and well-known industrial concerns, and it is not easily attracted by the private business unless an ample margin of collateral security can be offered.

801. Payment by instalments is the remedy generally agreed upon. In our opinion, it would be necessary to allow it in difficult cases. It should, however, be conceded only in those cases—relatively few, according to the Board of Inland Revenue's

figures—and where, for instance, the proprietor was in a position to pay half the levy at once, the concession should be confined to the balance. Our reasons very briefly are :—

(i) that the allowance of a special method of payment to a particular class would be bound to create some inequality of treatment as between individual levy payers (*cf. para.* 856).

(ii) that the future course of a firm's profits could not be foreseen; if it were markedly downwards, either the firm would be involved in hardship (if the full instalments continued to be paid) or the Exchequer would lose (if the tax were discharged, or the levy valuation revised).

(iii) that from all points of view—in order to secure the anticipated yield, and in order to avoid an undue continuance of friction—the completion of the levy in as short a period as possible would be desirable.

We must add that, at the best, the instalment system would in general be a very incomplete remedy for hard cases, in view of the heavy annual demand which it would entail.

X.—THE LEVY AND AGRICULTURAL LANDOWNERS.

802. We contemplate that a special class of difficult cases would arise among agricultural landowners. The difficulties would be similar to those occasioned by the death duties (*cf. para.* 505 *et seq*) but would be aggravated by the heavier rates of tax. It appears that in a large proportion of cases (though not so large as in the case of the death duties) the owners would have sufficient resources apart from their land to free them from any great degree of special embarrassment. In the balance of cases, it would be necessary for them either to realise part of the property, or to raise a mortgage, or to pay the levy over a number of years. The landowner, having the security of his land to offer, would be in a better position to raise money than the individual who had all his wealth locked up in a private business. It is sometimes pointed out that he might already have mortgaged his land heavily; but, if he had done so and the net capital value of his ownership were still high enough to involve him in a considerable charge to the levy, it is clearly implied that he would still have a broad margin on which to raise further loans. On the other hand, mortgage interest presses heavily on land where the money income represents a low rate on capital. It would be important to recognise this factor in determining to what extent payment should be allowed by instalments.

XI.—THE REDISTRIBUTION OF SAVING POWER.

803. The redistribution of wealth may be considered firstly from the point of view of industry, as concerns the supply of capital, and secondly from the point of view of the individual, as concerns social well-being. We are here concerned with the first aspect: we deal with the second in paragraphs 832-836.

804. A levy raising £2,500 millions might, according to the Board of Inland Revenue's estimate, effect a gross annual saving of interest of £125 millions, but of this sum £77 millions would be swallowed up by a loss in Income Tax, Super-tax and death duties, assuming the rates of 1925-26 to continue. A clear implication is that those who, as a class, would pay the levy bear such heavy taxation under the present system, that, out of £125 millions gross income which they might lose as a result of the levy, their net loss would be only £48 millions, subject to such adjustments as would result from the difference in time at which the death duties would fall to be levied: further, this figure would be immediately lessened to the extent that the levy class might benefit from reduced taxation. The net loss, whatever it might be, would be balanced by the gain of some other class, since the levy would not directly destroy any real income but would merely alter its distribution.

We are, of course, speaking here only of the automatic effects of the levy, excluding the manifold reactions it would have on profit and income.

805. For the sake of illustration we will assume a levy raising £3,000 millions, with a net saving of interest of £58 millions per annum. We may take two hypotheses:—

(i) Let it be supposed that the £58 millions available are applied to reduce Income Tax and Super-tax, in such a way that the levy class benefit to the extent of £25 millions per annum.

(ii) Let it be supposed that part of the £58 millions is used for reduction of indirect taxes—the levy class benefiting to the extent of £4 millions—while the remainder is used for social expenditure.

In the first case the effect of the levy and subsequent policy will be to redistribute £33 millions of income in favour of Income Tax payers not subject to the levy: in the second case the effect will be to redistribute £54 millions, mainly in favour of the poorer classes not liable to Income Tax.

806. We are regarding income in the present context in its character of saving power. It is clear that if the £58 millions per annum released by the levy were wholly applied so as to relieve the taxation of the levy class in proportion to their contributions (assuming this to be possible) there would be no change either in the amount or distribution of total saving power. So far as the £58 millions might be applied to reduce the standard rate of tax, saving power would be distributed more widely over the general body of Income Tax payers. So far as indirect taxes might be reduced there would still be no change in the amount of saving power, but it would be spread out over a much wider area. Finally, so far as the £58 millions were applied in social expenditure, the State would be spending income, which but for the levy might have been saved.

807. Thus the redistribution of saving power is limited to some figure, greater or less, under £58 millions per annum. Some part of the amount redistributed would be saved, although doubtless a smaller proportion than if it had remained in the hands of the levy payers. It seems then that, apart from psychological reactions, the direct automatic effect of a Capital Levy on savings would be much less serious than might be thought.

808. It is important to observe that as public companies would not be liable to the levy, their saving power would not be directly affected by the levy itself : it would be increased so far as the levy might be used to reduce the standard rate of tax. At the same time, dividend policy might be affected in some degree. Mr. Hobson thought it possible there might be some tendency to distribute a larger proportion of the annual income in order to facilitate payment of the levy by shareholders (*Ev. Appendix* VII : *para.* 11). Professor Scott contemplated that the state of dislocation due to the levy would probably dispose directors to be rather more cautious; on the other hand shareholders would probably press for increased dividends. (*E. in C.*, 13-15). The effect on balance is a matter for speculation, but we do not think it would be of great importance in either direction, if the levy were well received.

809. On the other hand, if the levy were to cause any serious dislocation of industry, it is clear that the reactions on the saving power of public companies—as indeed of the whole community—might be very injurious.

XII.—PSYCHOLOGICAL EFFECTS OF A LEVY ON SAVING AND ENTERPRISE OF INDIVIDUALS.

810. The Association of British Chambers of Commerce held that, while a high rate of Income Tax tends to discourage saving, a levy would, owing to its psychological effects, discourage saving to a much greater extent (*Ev.*, *p.* 579 ; *E. in C.*, 58). The fear of repetition, which we have discussed in paragraphs 744-8, is an important reaction to be considered. Professor Macgregor held that those liable to the levy would have no reason to diminish savings, except so far as they suffered from this fear (*Ev.*, *Appendix* VIII ; *para.* 17). Professor Scott noted another kind of reaction; he thought those subject to levy were likely to feel a grievance, with an initial tendency to diminish savings. As time went on, if the levy were not repeated, this feeling of unfair treatment would decrease (*E. in C.*, 14).

811. If apprehension were very acute—if, as Mr. Paine suggested, the whole sense of security and confidence were destroyed—the effect on saving and enterprise would inevitably be serious. We have expressed the belief, however, that a guarantee against repetition within a limited time might be given, and that this might to some extent allay apprehension.

812. Another factor of importance, in considering the psychological effect, is the use made of the net Budget saving. If the levy were intended, in the words of Professor Pigou, as " a piece of fiscal technique designed to lessen the discouragement caused by high tax rates to work and saving " (*Ev., p.* 437; *E. in C.*, 12), the levy would naturally be used to reduce the Income Tax and Super-tax. The psychological effect on saving in such a case would clearly be better than if the taxation upon food were reduced, and the exemptions and abatements of Income Tax payers readjusted, as recommended by the Trades Union Congress (*Ev., p.* 587; *E. in C.*, 7).

813. *The effect on saving.*—On the hypothesis least favourable to the Capital Levy, the comparison is between the effect of annual taxation continued at the present level, and the effect of a levy (i) not followed by any reduction in the Income Tax, and (ii) giving rise to a strong fear of repetition.

814. Even under such conditions there might be a stimulus to saving in certain exceptional cases, e.g. :—

(i) That of the levy payer who had determined to save a definite net sum, and who might be impelled to repair, if he could, the damage done by the levy;

(ii) That of the levy payer who was allowed to pay in instalments, and was induced to create special savings, as suggested by Mr. J. A. Hobson.

(iii) That of the person, not subject to the levy, who was determined to save a definite net sum, and who was driven by the fear of liability to a future levy to make an extra effort, i.e., to save a larger gross sum.

(iv) that of the person whose prospective inheritance had been reduced by the levy falling upon his father (a levy to be followed by Estate Duty).

The general effect on saving would, however, undoubtedly be bad, and might be very serious.

815. The effect on saving, if the fear of repetition were not very active and if the Income Tax were reduced by something like 1*s.*, hangs on so many personal, etc., considerations that any conclusion is difficult and any precise conclusion impossible. The following analysis, however, may be attempted. We have in mind a levy raising £3,000 millions, and with a graduated scale resembling that suggested by the Labour Party.

816. Normally, the first layer of savings is composed of a man's more or less definite provision for his family in the event of his death, for any dependants, and for his own old age or retirement. It also comprises saving against future expenditure, such as the education of his children.

817. When there is a further layer of savings, the usual object will be an increase of income, permanent indeed, but immediately felt, in other words, saving by the individual in order that he may be richer now, and not only in order that

his successors may benefit. Admittedly this is a somewhat rough division. In both cases the savings may have for their immediate object the building up of a business.

We may consider, first, those not subject to the levy, and second, those subject to the levy.

818. (i) *Those not subject to the levy.*—The savings here would usually belong to the first layer.

Where the individual's existing investments were small, and his earnings moderate (not more, say, than £1,000 to £1,500), the possibility of a second levy would on the whole have little effect on him of any kind. It would depend largely on how much he hoped to accumulate. If he did not look beyond £5,000 (exempt under the provisional Labour Party scale), the Capital Levy would have no terrors for him. Even £8,000, under a scale 20 per cent. more severe throughout than that of the Labour Party, would pay only £300. If after a few years he prospered and became more ambitious, there is no reason why the idea of a levy should give him much trouble; general apprehensions as to a second levy would be likely to have died down, since we are assuming that they would never have been very active.

819. Where the existing investments more nearly approach the £5,000 limit of liability, the fear of repetition will be more of a reality. In the case of life insurance, the prospect of a second levy reducing the capital provision is likely to induce the individual to increase the capital sum assured, and perhaps on balance the normal individual might be rather stimulated.

820. When it is borne in mind that the lower rate of Income Tax (on the important assumption that it is to remain lower) will increase the margin for saving, the conclusion seems to be that the Capital Levy, if followed by Income Tax relief, would to some extent favour the savings of those not subject to charge.

821. (ii) *Those subject to the levy.*—The moderate fortunes will have suffered much less heavily than the large (£8,000 would pay £300, £10,000 would pay £660, and so on, under the Labour Party scale increased by 20 per cent). Up to a certain point, though not very far, the savings will still belong mainly to the first layer (family, etc., provision).

822. Normally it may be questioned whether the levy would cut far into the first layer of savings at any point. Would the £550 taken from the fortune of £10,000 cut into the taxpayer's definite and essential provision for his family, or would it merely cut into his savings with a view to an immediate increase of income? The answer would vary from individual to individual, according, e.g., to the size of the family for which provision had to be made. Everything would depend on the standard of living and saving which the individual had set himself.

823. It is suggested that, in the case of moderate fortunes subject to the levy, the first layer of savings will on the whole

be very little affected by the fear of repetition. In the case of large fortunes they will be still less affected. Here, however, the important point is the effect on the second layer of savings. On the one side is a not very certain relief from Income Tax of about 1*s.* at most. On the other is the possibility of a levy pictured on the scale of that already suffered.

824. Much depends on the personal inclinations of the individual. The prospect of a larger net return owing to reduced Income Tax will no doubt be stimulating, so far as it goes. But the continuance of the 1*s.* relief cannot be relied on with certainty. On the other side is the possibility of a second levy, representing for all large fortunes a very severe burden. Even if the possibility is fairly remote, it might count for a good deal, especially in conjunction with any feeling of grievance over the first levy.

825. It is difficult to resist the conclusion that the psychological effect of a levy would, on balance, be rather inimical to saving, so far as concerns those subject to it. The " automatic " savings of the very wealthy may be excepted, but it has to be remembered that their power to save will have been somewhat drastically reduced by the diminution of wealth due to the levy already suffered. An exception may also be made as regards those who save from the feeling that it is a social duty.

826. *Conclusion.*—Many more possibilities suggest themselves. For instance, the effect of the levy would vary to some extent with the age of the individual. It would be relevant to ask, How far are his habits fixed? What is his expectation of life for the purpose of making good the inroads of the levy? and so on. But an impression emerges on the whole that the Capital Levy, if it were fairly well received, and if it were followed by a reduction of Income Tax, would tend to be favourable to the saving of those not subject to it, while unfavourable to the saving of the levy payers.

827. There would, we think, be a balance of advantage to saving, if the whole of the net Budget relief secured by the levy were used to reduce the Income Tax (or the death duties), if this taxation relief were continued, and if the fear of repetition were reduced to a minimum. Except in those very favourable conditions some disadvantage would be likely, and this might be serious, if the general effects of the levy were injurious, of if the fear of a second levy were a strong influence.

828. *The effect on enterprise.*—In discussing psychological effects, witnesses usually yoked enterprise and saving together. Certain distinctions, however, merit attention.

(i) The direct effect of a levy on enterprise would be felt over a much smaller field than the direct effect on saving.

(ii) The motives of saving and of enterprise may be as far apart as prudence and the readiness to take risk. Saving and enterprise might therefore be differently affected by a levy.

829. The effect on enterprise has to be considered in relation to the private trader. Professor Pigou (who was not in favour of a Capital Levy—*cf. para.* 733) suggested that the main argument in favour of a Capital Levy is the danger that heavy annual taxation will discourage work and saving; under a special levy not expected to be repeated there would be no corresponding discouragement. (*Ev. p.* 437; *E. in C.* 11).

830. It seems clear that new businesses in particular would be somewhat encouraged by a reduced Income Tax. But everything depends on the feeling as to future prospects. Ambitious and speculative businesses have to look far ahead and need a clear horizon. They might be stimulated by a levy, if it were a general success—if there were no serious dislocation of industry or contraction of credit, and so on. It would also have to be reasonably certain

(i) that the levy would not be repeated; and
(ii) that the relief from Income Tax would continue.

831. The business man, however, who has suffered at all severely, will hardly consider 1*s.* relief from Income Tax an adequate compensation. Payment by instalments, when allowed, may not much improve matters in this respect; for, while it lasts, it resembles the very thing which a levy is supposed to cure, i.e., heavy annual taxation.

The ultimate effect is as difficult to determine with any precision as in the case of saving. We think, however, that it could only be favourable to enterprise at all, if the conditions were very fortunate. In any case we are not of opinion that a levy of £3,000 millions, which enabled the Income Tax to be reduced from 4*s.* to 3*s.* (without any certainty that the 1*s.* gain was permanent), could impart any great stimulus to enterprise. Now that the smallness of the net annual saving possible under a levy has been established, what Professor Pigou suggests as the main argument in favour of a levy appears to have little force. It has no force at all unless it be assumed that the net annual saving would be used to reduce direct taxes.

XIII.—THE REDISTRIBUTION OF WEALTH.

832. Little evidence of a definite nature has been put before us on this point. In general, the witnesses have expressed the opinion that a levy would tend immediately to lessen the inequalities of the distribution of wealth, the extent of the movement depending upon the steepness of progression of the levy and the particular application which the Government made of the net saving of interest.

833. The Trades Union Congress suggested that, as the levy would be confined to individuals worth more than £5,000, whereas the holders of war debt were presumably spread over a somewhat wider range of fortunes, the direct effect of the levy would

be somewhat to reduce the existing inequality of wealth. (*Ev. p.* 588; *E. in C.* 15.) The effect on distribution does not appear, however, to depend on the relation between the wealth of the levy payers and that of the debt holders. While it is, of course, recognised that no real wealth would disappear as the result of the operation, the effect of the levy would be to transfer a part of the wealth of the levy payer to the debt holder in redemption of a loan which he has been accustomed to regard as wealth. The levy payer, as such is poorer; the debt holder, as such, is neither richer nor poorer. Thus, as pointed out by Professor Macgregor, the levy cancels and does not transfer capital values, and the equalisation of wealth acts once only, through the sums levied, not twice through the transfers of those sums (*Ev. Appendix* VIII; para. 16). A levy on a highly progressive scale would, therefore, in the first place reduce inequalities of wealth; it would not destroy real wealth, but it would decrease the share of the levy paying classes and increase the share of classes not subject to the levy.

834. For the future, the claims on the national production of those classes subject to a levy raising about £3,000 millions would be diminished to the extent of the consequent net decrease in their incomes, round about £58 millions (*cf. para.* 807). This is the sum which the State would be free to apply to the reduction of taxation or to additional expenditure. No immediate improvement in the standard of living of the poorer classes would necessarily follow, unless that free balance were applied in a manner beneficial to them. Indirectly, however, there might be certain influences following a levy which would improve their position. If, for instance, the result of the levy were to lower general prices, there would be a temporary advantage in the increased purchasing power of wages; unless the levy at the same time stimulated trade, this would be quickly offset by a fall in output, probably leading to unemployment and reduction in wages.

835. Some effects might also be felt from the influence of a levy upon the amount of savings. If the levy induced the classes which had paid it to restrict consumption, particularly of luxuries, there might be a greater concentration of output upon capital goods and necessaries, leading to greater production and lower prices, from which the poorer classes would especially benefit. On the other hand, if the levy caused a reduction in savings, and an increase in the rates of interest, there would be a tendency to divert a larger share of production to holders of wealth and to counteract the levelling effects of the levy.

836. It is, however, in the use made by the Government of the net saving in interest that the clear source of redistribution lies. If that saving were applied to the reduction of indirect taxation. this would be an immediate benefit most largely felt by the poorer classes. If, again, it were used to further the extension of social services, it is to be presumed that the benefit would lie

mainly in the same direction. But equal immediate benefits to the poorer classes could be achieved by putting 1*s*. on to the Income Tax. A levy of £3,000 millions appears therefore as an ineffective instrument for any large alteration in the distribution of wealth. It is not on a scale which (in the words of Mr. Keynes (*Ev.*, *p.* 534; *E. in C.*, 2 (3)) " would take it out of the category of a mere modification of the incidence of taxation."

XIV.—THE EQUITY OF A CAPITAL LEVY.

837. As we have already pointed out elsewhere in our Report, the National Debt, so far as it is internally held, involves no direct money burden upon the nation as a whole. It does, however, through the transfer of resources involved in the payment of interest and repayment of principal, impose a burden upon taxpayers which is in the nature of an adjustment amongst individuals of the real burden incurred at the time the money was spent for war purposes.

838. A levy upon capital in the form proposed would throw the burden of repayment, to the extent of the debt redeemed, entirely upon those individuals in possession of material wealth to an amount exceeding £5,000. If the State finds it necessary to raise a huge sum by extraordinary taxation, the burden must fall in the main upon the classes in possession of accumulated wealth, whatever the position may be in equity. Nevertheless, the arguments for and against the broad fairness of such taxation have to be considered, and must be of practical importance so long as the necessity of raising an enormous sum is open to debate.

839. Dr. Dalton suggested that the main argument from equity turned on the fact that those who fought in the War were now heavily taxed to provide interest for those who stayed at home, and, in many cases, made large fortunes out of the war-time necessities of their country. He regarded it as one of the great advantages of the levy that it would be paid by elderly men who did not fight in the War, but were richer at the end of it than at the beginning. (*Ev.*, *p.* 492; *E. in C.*: 5).

840. It is unnecessary to consider in detail all the implications of this argument. It may, however, be desirable to point out that personal service during the War was given in many ways, and its nature in many cases obviously depended upon causes which it was beyond the power of the individual to affect. On the other side, so far as there was an increase of wealth in the hands of a limited section of the population, it did not arise, as is shown in the Report of the Select Committee on War Wealth, by any means entirely from the cause emphasised by Dr. Dalton.

841. No definite dividing line can in fact be drawn between those who fought in the War and those who would pay the levy, and Dr. Dalton himself admitted the decreasing importance of

his argument in view of the lapse of time since the War. (Q. 6940.) Logically, the contention, in the form in which it was put, suggests that exemption from the levy, or some abatement therefrom, should be granted to those owners of wealth who fought in the War, but this forms no part of the scheme. In our view, the argument can only point to the fact that the burden of a levy would fall with especial weight on those persons who were unable to take a combatant part. This result would be due to some extent to the creation of war fortunes, but largely to the normal expansion of wealth in the higher age-groups.

842. We do not see, in these considerations taken alone, any cogent ground for a special distribution of taxation for the repayment of debt. There is, perhaps, some force in the form in which the argument was put forward by the Co-operative Congress. They took the view that it would have been considered equitable if a larger proportion of the cost of the War had been raised by taxation during the period of the War; they therefore thought it not inequitable to take in their capitalised form the sums that might have been taken by Income Tax during the War. (*Ev.*, *p.* 565; *E. in C.*: 15.)

843. It will probably not be disputed that the State has a right to command all resources needed for a national emergency. There does not, however, seem any valid reason to suppose that, had it been decided still further to increase taxation during the War, the additions would have been entirely limited to income taxation. Even had it been so, it is clear that not only incomes that were saved would have been taxed, but also incomes that were in fact spent. There is little ground, therefore, for regarding a levy at the present day as the capital equivalent of taxation which might have been imposed during the War, and the difference is naturally accentuated by the changes in the ownership of wealth which have since taken place.

844. A quite distinct argument urged by the Co-operative Congress was that existing wealth had been preserved by the War and its holders had benefited; future producers would have produced their own capital, even if existing wealth had disappeared as a result of the War. In their view the present generation had benefited more than future ones (*Ev.*, *p.* 566; *E. in C.*, 16). The witnesses admitted in oral examination that a disappearance of existing wealth would have made it impossible to maintain the standard of living either for this or for future generations.

845. We think it fair to regard the preservation of existing wealth as conferring a special benefit on the present generation, but this benefit cannot be dissociated from the effort and sacrifice—for the future, as well as the present—which they made in the War. On general considerations, which we have indicated in other parts of our Report, we think it right that considerable efforts should be made by the present generation

to reduce the load of debt. It does not, however, appear to us that the equitable distribution of the burden between individuals of the present and future generations in itself renders desirable a large redemption of debt by means of a Capital Levy.

846. We have dealt above with arguments advanced in justification of a levy on grounds of equity. On the other side, witnesses who were opposed to a levy considered it inequitable that the burden of debt repayment should fall entirely upon accumulated wealth, very often saved by the self-denial of the taxpayer, and in many cases representing provision for old age, or for dependants. The levy would penalise the thrifty, while in no way reaching the spendthrift. The Association of British Chambers of Commerce gave the following illustration: "*A*, as a single man, has had for 20 years an average income of £2,000 a year, and, having no family to provide for, he has lived up to his income. *B*, a married man with the same income for the same period, and having a family, has saved one-half of his income, and has therefore accumulated £20,000. *A* would have no capital on which a levy could be made, but *B*, having paid tax, both on the income derived from his savings as well as on his earned income, would be subject to the levy." (*Ev. p.* 578; *E. in C.* 36.) The Chambers of Commerce, and similarly Mr. Paine, emphasised the distinction between taxing the capital of the saver and taxing his income, while leaving his capital intact. It appears to us that the comparison is largely one of degree, depending on the severity of the taxes, and that in strict logic the distinction does not carry much weight; at the same time, right or wrong, it makes a wide appeal to the instinct of fairness. We think that the argument is strongest when taken in conjunction with the time element. The levy does not fall equally even on members of the same generation; since it would be raised at a single point of time, it would generally fall with the most weight on those who had been saving longest. As Sir F. Schuster said, "a man who has saved all his life is much harder hit than a man who is beginning and who has got time before him when he can earn something for himself." (Q. 7841.) Even in this case, however, the position is not without complications; for example, the much lighter taxation of the pre-war period left a wider margin for saving to those who were then building up a fortune, and on this account the time element may lose some of its importance. Nevertheless, even if it were agreed to be equitable that a levy should fall upon one particular generation, it is clear that the impost would be quite arbitrary in the manner in which it hit different individuals at different stages in their accumulation of wealth and without regard to differences in their obligations.

847. An allied question, to which considerable attention was directed, was that of the equity of immaterial or personal capital

being exempted from assessment, as it would be under a levy of the form proposed. In general, the advocates of a levy regarded a valuation of brain capital as impracticable. Dr. Dalton considered that, from the point of view of equity, there was a good deal to be said for an additional tax for a term of years upon large earned incomes. Professor Pigou regarded this expedient as undesirable, since the main advantage of a levy would be to make possible a reduction of rates of taxation on marginal work and marginal saving. Although he favoured the inclusion of brain capital in principle, he pointed out that the yeild would be small, relatively to the yield of the whole levy, and perhaps not commensurate with the technical difficulties involved. (*Ev.*, *p.* 437; *E. in C.*, 8.)

848. From the point of view of equity, it seems wrong in principle that large earned incomes should escape any share in a special contribution to the repayment of debt, and actually derive a benefit if, following a levy, the rates of income taxation were reduced. At the same time, this seems not so illogical when it is considered that the levy, even as regards physical wealth, is based upon its value as at one point of time only, without regard to the future income (perhaps more, perhaps less, than the present) which may be enjoyed from its possession.

849. The basis of assessment of brain capital generally proposed by those favouring its inclusion in a levy, is a capitalisation of the individual's earning power, as indicated over a period of years prior to the valuation. It is clear, however, that in practice, such an estimate would in many cases not be realised, as it is impossible to foresee all the circumstances which may affect earning power in the future. Moreover, the levy in such a case would have to be paid by instalments, since the capital does not exist in a realisable form, and would, therefore, differ little from the additional tax suggested by Dr. Dalton. In effect it would be a tax on ability.

850. An alternative suggestion is that the levy should be based, not upon a capitalisation of earnings, but upon the amount of wealth invested in the education and training of the brain capitalist. While this would eliminate the ability tax aspect, it is evident that in many cases the means of payment would not exist. The difficulties of adopting the course are obvious; to determine the real present value of the original investment would involve the impossible task of judging what part of the taxpayer's earning power was attributable to the investment as distinct from his individual ability.

851. In spite of the inequity of exempting large earned incomes from their share of a special repayment of debt, we see no practicable method of bringing them within the levy proper. The only suggestion which we think would require to be considered is that of Dr. Dalton for an additional annual tax, and that course is perhaps open, not only to the defect mentioned

by Professor Pigou, but to the accusation of unfairness, if the levy takes no account of changes in the future income value of material wealth.

852. Objection was also taken by witnesses to a levy which proposed to exempt fortunes not exceeding £5,000. We have already referred to the practical grounds for such an exemption (*para.* 722). On purely equitable grounds, it might be held that account should be taken of individual circumstances. Thus, assuming that the capital of husband and wife would be aggregated for the purpose of a levy, it might be argued that in the case of single persons the exemption limit should be lower, just as the Trades Union Congress suggested that the possibility of an allowance for family responsibilities should be considered in relation to fortunes between £5,000 and, say, £10,000 (*Ev. p.* 589; *E. in C.*, 31). It may be remarked that under the present Income Tax, if the somewhat low rate of interest of 4½ per cent. is assumed, a married couple would be exempt from taxation if their sole income was derived from the possession of £5,000 capital; a single person would not be exempt if his capital exceeded £3,000.

Since the proposal of the levy is to throw a much greater burden on capital than under the present system of taxation, it appears that a general exemption limit of £5,000 cannot be justified on equitable grounds.

853. We have so far considered the equity of levying special taxation on one particular generation and on one particular section of the community; another class of questions is concerned with the extent to which a non-recurrent tax on capital can be adjusted to the taxpayer's ability to pay. It was urged by Mr. Pethick-Lawrence that Income Tax alone took no account of a man's wealth; equally a levy took no account of income. By combining both a better result would be obtained (*E. in C.*, 11). In the course of his examination, he agreed that this was not an argument solely related to a Capital Levy; it would equally apply to a permanent tax on capital (Q. 6283). The argument, it seems to us, really involves a condemnation of the present system of taxation, as not sufficiently directed towards the taxation of capital either through the death duties or through the differentiation in the Income Tax against investment income. It has no special bearing upon the question of debt repayment, and indicates a continuing tax adjusted to the supposed higher ability to pay, rather than a single and exceptional operation such as is proposed in the Capital Levy.

854. We do not propose to consider the several problems involved in valuation for a levy, since the subject was fully explored in connection with the proposed levy on War Wealth, and the Board of Inland Revenue are satisfied that the assessment in the case of a Capital Levy, while still of great difficulty, would be less difficult than under the former scheme. There are, however, one or two aspects which we may briefly notice.

855. The Association of British Chambers of Commerce were of opinion that valuations of various kinds of property would necessarily be in large measure arbitrary and therefore inequitable, and they expressed the view that those whose property was in a less realisable form would have to make greater sacrifices than those possessed of capital in an easily realisable form (*Ev. p.* 578; *E. in C.*, 32-33). It is, we think, true that valuations of capital, which in many cases depend greatly upon matters of individual opinion, cannot for purposes of taxation be taken as reflecting differing circumstances with anything like the general accuracy of assessment upon an income basis. Particular instances are afforded by mines or by rubber plantations, the potentialities of which may be extremely uncertain. Some considerable inequities as between individuals seem bound to arise in the administration of an operation of the magnitude proposed. On the second point —the differing marketability of assets—we should anticipate generally some corresponding compensation in the valuation. An industrial investment with a very narrow market is in general valued at a lower figure than it would command with a free market. At the same time, we realise that the burden cannot possibly be uniform in this respect.

856. Even if it were possible to have exactly correct valuations as at a given date, there would sometimes be great inequality in the weight falling on different levy payers with equal amounts of capital. This is obvious in the case of investments of the more speculative class, the value of which at the levy date might be quite unrepresentative of their value over any reasonable period, being much higher in one case and much lower in another. The inequality would be thrown into relief if, while immediate and final payment were required in respect of such wealth, payment by instalments were allowed in cases where the taxpayers' wealth was locked up in land or in private businesses, the original valuation being open to revision in case of need. Such revision could hardly be altogether avoided, since alteration of circumstances within the instalment period might make payment on the original valuation impracticable. This sort of inequality might be clearer still as between two individuals each having a private business, one being allowed to pay by instalments, and the other being required to pay in a lump sum, owing to the fact that he possessed outside resources; in the latter case it is assumed that no revision would be allowed, whatever the subsequent history of the business might be.

857. Life-interests are usually regarded as the chief obstacle in the path of fair valuation. If the separate interests were valued according to life expectation, the values set upon them would be falsified on every occasion, except in the rare case where the individual's length of life conformed exactly to the

average. The Board of Inland Revenue (*as noted in para.* 713) have suggested an alternative plan, viz., that the levy should be assessed " on the whole value of settled property and payable out of the settled fund, the rate of duty both for the settled fund and for the free wealth of the life tenant being found by aggregating the value of the settled property with the life tenant's other property." If this were done, the successor to the life tenant who is in enjoyment of the property at the levy date would suffer in respect of that property, not by reference to his own total means, but by reference to the total means of the life tenant. The result might be very advantageous to the successor in one case, and very much the reverse in another. There may seem to be something arbitrary and inconsequent in the method, but on the other hand it is established in the case of the Estate Duty, and it would not seem altogether unreasonable that the Estate Duty principle should apply to prospective interests in property, which in the majority of cases could only become vested on the occurrence of a death. Besides, the result would not differ greatly from an ordinary incident of the levy as applied to free property, for the levy would in many instances fall on a property shortly before the death of the owner and the distribution of the estate. In such a case it might be said that the Capital Levy on the property in question was in effect falling upon the several beneficiaries not according to their own wealth but according to that of the predecessor.

858. *Conclusion.*—We are not prepared to lay it down as an abstract proposition that the Capital Levy, viewed simply as a tax on the accumulated wealth of a particular generation, must, in all circumstances, be condemned as unfair; at the same time, we consider that, even in this broad aspect, very special circumstances are required to justify it, and that such circumstances, while possibly realised in 1920, do not exist now. Descending from the abstract principle of the levy to its application, we conclude that it would necessarily involve inequity in many ways; it would penalise the thrifty in a more arbitrary manner than annual income taxation (*para.* 846), it would give a disproportionate advantage to large earned incomes not depending on material capital (*para.* 851) and, in valuation and collection, it would entail inequalities much more pronounced than are found under the existing system.

XV.—CAPITAL LEVY: SUMMARY AND CONCLUSION.

859. Gathering up the different parts of our survey, we may emphasise once more the vital importance of the levy payer's attitude. We have to estimate the sum of the effects, psychological as well as physical, likely to ensue from a levy, if it were received with a fair measure of good-will; we have also to foreshadow the effects, if it were to give rise to nervousness and hostility; and we have to form our own judgment as to the kind of reception most likely to be accorded to it in fact.

860. *The physical achievement of a levy.*—The collection of a sum in the neighbourhood of £3,000 millions for the redemption of debt would, in itself, be impressive. But the value of wiping out so much debt, apart from the annual saving of interest, is not easy to assess. Several witnesses suggested that its main practical importance was due to the possibility of another war; in such an event, they pointed out, it would be much less difficult to raise the necessary funds, if the debt had been reduced to more moderate dimensions. This may be admitted; on the other hand, if it is necessary to take account of the possibility of another war on a big scale, it also seems necessary to face the possibility that it could not be financed without some considerable inflation, which, whatever its other results, would incidentally reduce the burden of old debt. From this point of view a large redemption by means of a levy might be very expensive, and the value of the result is not altogether certain.

861. The main burden of the debt, according to the general trend of the evidence, lies in the annual taxation required for interest and Sinking Fund, and in any hindrance which that taxation may imply to the raising of revenue for desirable expenditure in social or other directions. We have seen that a levy raising £3,000 millions might effect a net annual saving of something under £60 millions, which could be used either to reduce existing taxes, or to provide social benefits, or to do both. If the object were to reduce indirect taxation and to spend more on, e.g., education and pensions, about £60 millions could be raised without a levy by the addition of 1s. to the Income Tax or, in other words, by restoring the standard rate of tax to the level of 1922-23. The levy would, however, ensure the saving once and for all, whereas the extra Income Tax would have to be reimposed year by year.

We should add that it is open to doubt whether the economic situation in its widest aspect is such as to justify increased social expenditure at present. Lord Bradbury did not think that the existence of the debt-charge in fact necessitated any restriction of public expenditure for other purposes, beyond what would be required by reason of general economic conditions independent of the debt-charge. But he thought that such conditions did require a very rigid restriction, and he regarded the effect of the debt-charge as an incentive to economy of other public expenditure as a most valuable influence. (*E. in C.*, 13.) We think there is considerable force in this view.

862. The possible redistribution of net income to be effected by a levy of £3,000 millions would be confined to a figure round about £60 millions, and if, as contemplated by some of those favouring it, the levy were to be used partly so as to reduce the Income Tax, the limits of possible redistribution in favour of those not liable to Income Tax would be further

narrowed. Even as regards relief from indirect taxes, some share of the benefit to net income would accrue to the Income Tax paying class.

863. Industry would, of course, physically benefit from a reduction of the Income Tax, so far as the levy might be used for that object. But we have seen that there is a tendency to exaggerate the burden of the Income Tax on industry, which at the present standard rate of 4*s*. is not by any means unbearable, and which is no longer felt in the same way as if high income taxation were a novelty. Although a diminution of, e.g., 6*d*. in the pound must always be welcome, the tax is not now at a level where such a diminution would cause any intense relief. While it would be a clear gain so far as concerns the reserves of public limited companies, in the case of large private businesses it would be only a slight offset to the effect of the levy.

864. Thus, in the physical aspect, the positive achievement of a levy would be on a smaller scale than is commonly supposed. It would be disappointing to very many of those who support it. Both Professor Pigou and Mr. Keynes, who had favoured a levy in the circumstances of the immediate post-war period, informed us that they themselves had only recently come to realise the extent to which the diminished yield of ordinary taxation would eat into the gross saving of interest. The Trades Union Congress, in their first evidence before us, showed quite clearly that they had not conceived the importance of this point; they expected greater results both in facilitating social legislation and in enabling indirect taxes to be reduced than a levy could in reality achieve.

865. In different circumstances a levy might be a far more effective instrument. Thus, in the later stages of a great boom, the scale now required to yield £3,000 millions might yield very substantially more, with a correspondingly greater gross saving of interest, if the same rate of interest on the debt be assumed. At such a time there would be a prospect of price-deflation in the natural course, such as to intensify the burden of debt interest; if this were combined with the prospect of exceedingly heavy annual taxation—particularly of a heavy *increase*—as the only alternative, the positive case for a levy would be much stronger, and it would have a serious claim to consideration. This was exemplified by the post-war boom, although the most skilful forecasts of annual taxation requirements were to some extent liable to be falsified. "What I wanted to avoid," Mr. Keynes told us, "was an Income Tax in excess of 6*s*. and the argument for avoiding Income Tax in excess of 6*s*. is quite different from the argument for reducing Income Tax from 4*s*. to 3*s*." (Q. 7577). We may also note the views which Lord Arnold expressed in the House of Commons in the last year of the War as to the probable rates of taxation necessary if a levy were not adopted "The alternative means a very high Income

Tax and a general rate of not less than 7*s.* 6*d.* in the £, the actual rate, with abatements on the one hand and Super-tax on the other, varying from about 3*d.* in the £ on the smallest incomes liable up to at least 12*s.* 6*d.* in the £ on the largest. I need not labour the harmful effects of such a tax, they are patent to everybody " (House of Commons, Official Debates, 23rd April, 1918, col. 898).

866. Immediately after the War the argument for a levy was much stronger than it is now. Apart from the prospect of price deflation (which may have been imperfectly realised) and of heavy annual taxation (which may have been over-estimated), there were other advantages. In particular, the end of the War was a unique occasion which the more wealthy classes of the nation might well have been asked to mark by a special and personal contribution. In present circumstances the advocates of a levy have a far weaker case. Certainly, whether regarded as a means of lightening the annual burden on industry, or as a means of reducing indirect taxes and increasing expenditure on social objects, it would, in our opinion, yield physical results quite disproportionate to the magnitude of the operation.

867. *General effects of a levy on industry, &c., if received with a fair measure of goodwill.*—If a levy were reasonably well received, and if it did not give rise to any strong fear of repetition, we think it would cause less disturbance than many of its opponents have taken to be inevitable. There would undoubtedly be the risk of a fall in the value of securities outside the gilt-edged area, of a fairly considerable restriction of bank advances and of instability in the value of the currency. If, however, the arrangements for payment of the levy were skilfully conducted, and banking policy were specially directed so as to maintain equilibrium in the credit position, we think that it might be possible to keep any adverse effects within moderate bounds. There might be some immediate reaction favourable to the prices of Government securities, and perhaps to the general rate of interest.

868. The amount of friction and dislocation to industry as a whole, and the consequent effect on employment and the workers' standard of living, would largely depend on the factors we have just mentioned—i.e., on the extent to which depression of security values, restriction of bank credits, &c., could be avoided. If these problems were satisfactorily solved—in itself a considerable assumption—and if there were no general nervousness, it appears that the disturbance need not be serious, so far as concerns the great proportion of big industry carried on in this country by joint stock companies. The trouble would be much greater in the case of private businesses, the proprietors of which were liable to large payments of levy. As we have seen, the proportion of cases in which it would be acute is comparatively small, since the wealthy business proprietor usually has large resources outside his own concern. There would, however,

undoubtedly be instances of damage to highly progressive and efficient firms. Difficult cases could be partially met by allowing payment or part payment by instalments, but this would not be a really satisfactory remedy. Similar considerations apply in the case of agricultural landowners.

869. As regards the supply of capital to industry, the physical and automatic effect of a levy, though appreciable, would be less damaging than might at first sight appear. As stated above (*para.* 862), it follows from the present highly progressive rates of the direct taxes that the possible re-distribution of net income that might be effected by a £3,000 millions levy would be confined to something like £60 millions. Not all of this sum would have been saved, if left in the hands of the levy papers; not all would be spent, if it were distributed in relief of annual taxation. Again, it is to be observed that the levy would not directly affect the reserves of joint stock companies —an exceedingly important part of the national savings. The psychological effects on individual saving and enterprise are very much a matter for speculation, but we think they could only be favourable if the levy were carried through with a high degree of success, if it were followed by a reduction of direct taxation, and if the fear of repetition were only slight. Indeed, under the most fortunate conditions, we think there is little force in the argument that a Capital Levy, even if its sole purpose were to reduce the Income Tax, would stimulate enterprise. The reduction of Income Tax, which a levy of £3,000 millions would make possible, viz., about 1s. in the pound, would be too moderate to have any great effect.

870. The more general psychological effects of a levy, if well received, have also to be considered. *Ex hypothesi*, there would be no general feeling of grievance on the part of those subject to the levy. At the same time, even if a very favourable attitude on the taxpayer's part be assumed, there would inevitably be considerable friction in getting valuations settled and accepted, in view of the frequent difficulties of valuation and the large sums involved.

The effect on the poorer classes of a great burden readily shouldered by the wealthy should be distinctly beneficial, and might have good reactions on the relations between labour and capital. On the other hand, the positive results, as we have said, would be disappointing to very many, and we think this would largely neutralise any good results.

871. It is very difficult to judge how far the national credit abroad might be affected. In the long run it would seem to depend on the general effects—or, at least, the more observable effects—at home. If the levy could be smoothly and successfully worked, it would probably arouse a good deal of admiration. But the immediate result would almost certainly be a considerable shock to credit, and to restore the confidence of

foreign countries with any speed would be extremely difficult. We anticipate that deposits would quickly be affected. Even if public opinion at home were favourable to the levy, and if every attempt were made to reassure the foreigner that he would not be within its scope, it is probable that foreign depositors and investors would to some extent take fright and remove their money.

872. *Equity.*—In broad principle, the equitable aspect of a levy would vary according to the occasion of its imposition. On pure grounds of equity we think that there is no sufficient case for throwing so large a part of the debt burden on to a small section of the present generation.

In its application, the levy would operate with much less fairness between individuals than an Income Tax. The realisation of inequities would be spread over a considerable time, since, in many cases, they would only become apparent some time after the levy. Here again, however favourable the initial reception of the levy might be, the experience of it could not fail to give a well-founded sense of grievance in many cases.

873. *Effects of a levy, if badly received.*—If the levy were regarded from the first with intense fear and hostility, it would immediately set in motion a whole train of ill consequences. There would no doubt be active propaganda which would accentuate opposition, and it would be exceedingly difficult for the Government to explain the real nature and intention of their proposal so as to make it at all acceptable. We anticipate that the value of securities would quickly depreciate, that traders would reduce their stocks and their demand for credit, and that rapid deflation would ensue, which it would be exceedingly difficult to correct. This would involve serious friction and dislocation over industry as a whole, with very damaging effects on employment. The task of administering the levy would be rendered extremely difficult and perhaps impossible.

874. The disturbance created by the levy would far outweigh the good effects of reducing the debt. The general effects might be so detrimental to trade that the ordinary revenue would sharply decline and make any immediate reliefs from taxation out of the question. Finally, the long-range effects would be injurious. Saving and enterprise would alike suffer, and the return to trade prosperity would be endangered, and in any event seriously postponed.

The credit of the country abroad would suffer a severe shock, and, indeed, it is difficult to define any limit to the widespread harm that might be done to our trade and commerce.

875. *Probable reception of a levy.*—We do not suggest that a levy would necessarily arouse feelings so violent as to induce results of the most extreme kind. We are convinced, however, that it would be strongly resented. A levy

immediately after the War, when it would have appeared to partake of the nature of a war sacrifice, would have been more readily accepted, as witnesses both for and against the levy agreed. But exceptional circumstances are required to reconcile the owner of capital wealth to the levy idea. The opposition is no doubt founded partly on political suspicion and on prejudice: to impose a Capital Levy would be, as Mr. Keynes expressed it, to insult a set of very strong irrational feelings in men (Q. 7612), and such grounds of opposition are exceedingly difficult to overcome. It is possible that time may bring a change of ideas. Ideas of annual direct taxation have certainly altered very greatly in the last two decades, but there is no true parallel between annual taxes to which the taxpayer can get accustomed and a single drastic operation.

Finally, even if all misunderstandings were removed, there would still remain many valid economic grounds of objection which critics of a levy could take.

876. *Conclusion.*—We conclude that, even if there were a prospect of a Capital Levy being well received, the relief from debt which it offers would be insufficient to justify an experiment so large, difficult and full of hazard; this would hold good in any circumstances not differing widely from those of the present time. Further, unless a levy were accepted with more goodwill than it would be possible to anticipate under present conditions, it would be highly injurious to the social and industrial life of the community.

SECTION II.

SCHEMES OF TAXATION AND DEBT REPAYMENT.

877. In this Section we propose to consider certain taxation and debt schemes which have been brought to our notice. With regard to taxation we limit our consideration to proposals of a large character, such as might conceivably, either in the early future or in the long run, have an important influence on the rate of debt redemption.

The various schemes to be considered are as follows :—

(i) A Forced Loan Scheme : Forced Loans generally.

(ii) Annual Tax on Capital : increased taxation of Investment Income.

(iii) Composition for Income Tax.

(iv) A flat-rate Tax on Production suggested by Mr. P. D. Leake.

(v) Professor Rignano's Death Duties scheme.

(vi) A variant on Professor Rignano's scheme suggested by Dr. Dalton.

(vii) Mr. J. St. Loe Strachey's proposal for converting debt into Terminable Annuities.

(viii) Mr. Alfred Hoare's proposals for converting maturing loans.

(ix) Professor A. L. Bowley's scheme for varying the amount applied to debt redemption in accordance with the state of employment.

I.—EXAMINATION OF A FORCED LOAN SCHEME : FORCED LOANS GENERALLY.

878. Various schemes have been put forward since the War for some kind of forced loan. Among them is one elaborated in a book entitled " The State Debt and the National Capital " (Methuen, 1920), copies of which were sent to us by the anonymous author. This book contains a proposal for a series of forced loans with a view to more rapid redemption of the existing debt. The scheme, which is admitted " to embody to some extent the idea behind the Capital Levy," makes very big claims, and while we do not think they can be substantiated, we think an examination may be useful. We can only attempt to deal with the matter in its main aspects.

879. The scheme is that the Sinking Fund (then estimated at £40 millions) should be abolished and that a yearly forced loan should be raised at a low rate of interest. The loan, which is

spoken of as a Redemption Levy, would take the form of a levy on income derived from capital, i.e., "unearned" income. While great emphasis is laid throughout the book upon the elasticity of the proposals, the main scheme is worked out on the basis of a levy bearing 2½ per cent. interest, designed to raise £200 millions per annum and to replace the existing debt, in 25 years' time, by a new debt of £5,000 millions at 2½ per cent. This basis is adopted in the following explanation.

880. The abolition of the Sinking Fund would, the author states, allow 10⅔*d.* to be taken off the Income Tax on unearned income; this is rounded up to 1*s.* The Redemption Levy would be at the rate of 5*s.* in the pound on unearned income, except as regards War Loans (*see next paragraph*), where it would be only 2*s.* 6*d.* The levy payer would receive 2½ per cent. bonds equal in nominal amount to the levy paid, and redeemable at par in 25 years from the date of issue; it is assumed that the value of the £100 bonds would in the first place be £60, so that the "apparent" burden of the levy would be two-fifths of the sum paid, or, in other words, would be equivalent to 2*s.* in the pound on unearned income (or 1*s.* in the pound, so far as concerns War Loans).

881. The 5*s.* levy is regarded as built up of halves; the first 2*s.* 6*d.* implies a burden of 1*s.*, which would merely replace the 1*s.* taken off the Income Tax, while the second 2*s.* 6*d.*—again implying a burden of 1*s.*—is justified as a price to be paid by the capitalist for the great increase in capital values anticipated from the scheme. War Loans would be exempt from the second 2*s.* 6*d.* on the ground that there is little question here of appreciation or depreciation, and that a levy might give rise to charges of confiscation. It is assumed that the appreciation of capital values in general would be about 1 per cent. per annum. On £100 unearned income the rate of 2*s.* 6*d.* would raise £12 10*s.*, entailing an actual burden of £5. Thus, if the £100 were derived at 5 per cent. from £2,000 capital, the levy burden of £5 would be 25 per cent. of the assumed capital appreciation. Only if the £100 were derived at as a high rate as 20 per cent. from £500 capital would the levy burden be equivalent to the whole of a 1 per cent. appreciation.

882. The estimated effect of the scheme is worked out in the book in the following manner. The basic figures are illustrative rather than actual, but this does not affect the principle of the scheme.

	£ millions
(*a*) National Debt	7,500
(*b*) Interest charge, for which ordinary annual taxation would continue to be levied ...	375
(*c*) Redemption Levy of £200 millions per annum for 25 years would yield	5,000

£ millions.

(*d*) Reduction of interest due to replacement of £200 millions debt at 5 per cent. by £200 millions Levy Bonds at 2½ per cent. would be £5 millions each year (cumulative).

Since ordinary taxation would continue to yield the full initial interest charge (£375 millions), the reduction in interest of £5 millions each year would operate as a cumulative Sinking Fund amounting at 5 per cent. in 25 years to 2,500

which, together with the £5,000 millions raised by the levy, would extinguish the old debt. The levy would then cease.

(*e*) At the end of 25 years a new Levy Bond debt would have been created of 5,000

the interest charge at 2½ per cent. commencing at 125

and the amount maturing for repayment each year for a second period of 25 years being 200

(*f*) The whole of the £375 millions previously raised for the interest charge would no longer be needed when—at the end of the first 25 years—the old debt had been wiped out. £50 millions could be remitted from taxation and £325 millions raised for interest and repayment of Levy Bonds as in (*e*). In each subsequent year £5 millions more could be remitted from taxation till the end of the second period of 25 years.*

883. The first impression given by the scheme is one of great complication. Broadly, however, the proposal is simply to take 1*s*. off the Income Tax on unearned income, and to raise a forced loan of 5*s*. in the pound on unearned income at a rate of interest much below the market rate; while on an ambitious scale, it does not differ in its essential idea from other forced loan proposals aiming at a reduction of the debt-charge. The merit of the scheme is that, for good or ill, it discloses the theoretical framework. This disclosure would, we fear, not convince the ordinary levy payer that the levy was anything but very formidable. It does, however, provide a good basis for discussing the actual results which a forced loan of this type might entail, assuming it could be carried into operation.

* "It is not, however, contended that these results would be achieved, for (as stated again and again) the whole scheme would be made part of the annual Budget. It would thus be possible for Chancellors of the Exchequer to 'raid' the money set free by the Redemption Levy, as they used to raid the old Sinking Funds"—(p. 61).

884. The great positive advantage claimed for the levy is that it would help to create what is "absolutely necessary," "a great spate of new capital" sufficient to drown the National Debt. It would enable outstanding portions of the old debt to be successfully converted; it would lead to a great appreciation of capital values. The proposal, it is said, should be welcome to financial houses, good for trade and a tonic for the individual taxpayer. Apparently good trade would go hand in hand with increased prices, carrying with them "a smaller consumption of all commodities and services affected."

885. We have to ask what the nature of the burden would be, and whether it would ultimately be as light as is claimed. This involves the question whether capital values would be likely to appreciate to the extent suggested. We may then consider how the scheme would affect incomes of different size and constitution, and finally what result might be looked for on savings.

886. While the charge is said to be "assessed on capital," it is presumably meant to be met out of income, since it has to create a "great spate of *new* capital"; moreover, the proposal is to levy it in fact not on any valuation of capital, but on income derived from capital—i.e., on "unearned income," as understood for Income Tax purposes (although, perhaps, somewhat re-defined). Further, it is proposed that the collection of the levy should be fitted into the scheme of the Income Tax collection; it would, for instance, apparently be paid by companies and deducted by them from their dividends. Thus, so far as the scheme would impose a burden in the nature of a tax, it would do so in a form difficult to distinguish from an additional Income Tax on unearned or investment income.

The levy is intended to be at a flat rate, although the possibility of having to concede a progressive scale is recognised.

887. The levy payer, as we have seen, would in the first instance pay or suffer by deduction 5*s*. in the pound on all his unearned income. In exchange for a £100 levy payment, he would receive a 25 year bond of £100 nominal value which the author of the scheme calculates to be really worth £64 15*s*. 4*d*., but which he puts at £60 on the ground that the market would not reflect the full capitalised value. Accepting this figure, we get an apparent burden of 2*s*., against which has to be set the relief due to the 1s. reduction of the Income Tax. The wealthier taxpayer—though not the less well-to-do (*see next paragraph*)—would get the full benefit of the reduction, and thus his extra burden would be reduced to 1*s*. in the pound. It is claimed, however, that "there is strong ground for hoping that in most cases the cost would be more apparent than real" owing to the fall in the rate of interest and "the general capital appreciation" which is relied upon. A forecast is ventured that "in 20 to 30 years the capital values will appreciate 20 to 30 per

cent. approximately at the rate of £1 per cent. per annum." In so far as this result was achieved, it is to be noted that, unless production increased and dividends were enhanced, the fall in interest rates would react upon the total investment income, as would also the gradual supersession of the present debt by the levy bonds. It is, however, unnecessary, in view of our conclusion, to pursue the effects of this upon the rate of the Redemption Levy. The forecast of appreciation is at least optimistic, and it does not allow for the influence of world interest rates. But in any case, if special merit is to be proved, it must be shown that the scheme would have a greater effect on capital values than a simple Sinking Fund equal to the net burden of the levy. If, instead of the levy scheme, the Sinking Fund of £40 millions (taking the author's figures) were raised to £80 millions by putting an extra shilling of Income Tax on unearned income, redemption of debt would proceed just as rapidly. There is thus no reason why the levy should be any more effective in reducing the rate of interest and enhancing capital values than a simple Sinking Fund imposing the same net burden. If the cost of the levy to the taxpayer would be "more apparent than real," the same should be true of an extra 1*s.* of Income Tax on unearned income. Apparently, the levy could only make good its claim if it were very superior to the Income Tax in its action upon savings. The question of its action on savings is then of the most vital concern to the levy. Before we pass on to it, however, we must glance at the way in which individuals with different incomes would suffer.

888. The effect of the proposed flat rate would be to place the burden most heavily on the smallest incomes. The following figures relate to unmarried taxpayers :—

Income (all Unearned).	Rate of Income Tax (including Super-tax) (1926/27).	Rate of Redemption Levy.	Relief per pound if Income Tax reduced by 1*s.*	Apparent burden of levy per pound.	Net extra burden per pound under levy scheme.
£	*s. d.*	*s.*		*s.*	*s. d.*
100	—	5	—	2	2 0
400	1 6½	5	About 4½*d.*	2	About 1 7½
1,000	3 0	5	About 9*d.*	2	About 1 3
4,000	4 4	5	About 11¼*d.*	2	About 1 0¾
40,000	8 7	5	Just under 1*s.*	2	Approx. 1 0

Owing to the graduation of the Income Tax, the real relief corresponding to the nominal 1*s.* would be nil for the non-liable income, a fraction of a penny for the just liable income, and an amount increasing up to nearly 1*s.* for the large income. The extra burden imposed by the levy would therefore not be at a flat rate but would be actually regressive.

889. A further point may be noticed. The intention is to place the burden on people who will profit by a fall in the rate of interest. But some holders of investment incomes would lose rather than gain from any such fall, for example, mortgagees and holders of securities with a due date. Their capital is fixed, and when the rate of interest falls their income falls with it.

890. It would be open to the individual to borrow 3*s*. in every 5*s*. of the levy payment due from him, and to repay the loan with the proceeds of his levy bond; he would have to suffer the remaining 2*s*. as a tax. A very heavy strain would be put on people with small and moderate unearned incomes, and while they would borrow largely in order to meet the levy, the burden of 2*s*. in the pound (implying a varying net extra burden, as shown above) would no doubt have a considerable effect in reducing their consumption and forcing savings out of them; the same would be true of a regressive addition to the Income Tax.

891. The author of the scheme lays stress upon the "effectiveness of the new security merely as a stimulant to thrift." The bonds will be so attractive (not merely when the date of maturity approaches) that people will make special efforts to pay for them out of savings and hold them as investments. This supposed attractiveness of the bonds apparently rests on the author's calculation that the bonds will be really worth £64 15*s*. 4*d*. as against the assumed market value of £60. The argument seems to be self-contradictory, for a low market value would only be likely to arise by reason of the bonds being unattractive as an investment to the whole range of gilt-edged investors. This, in our opinion, they would certainly be. Capital appreciation is only attractive to certain very limited classes, and the great majority of investors want to hold securities in which it is clear that the income is all income and the principal is all principal. It is difficult to conceive then that the levy bonds would be at all generally effective in promoting savings.

892. We conclude then that, as compared with an increase of the Income Tax for Sinking Fund purposes, the levy scheme would not justify itself by creating large new savings, or by causing a great reduction of interest and appreciation of capital values. There would be no special effect on capital values such as to ease the real burden of the levy, and the flat rates would entail hardship to the smaller incomes.

893. *Forced Loans generally.*—As we have said, the author of "The State Debt and the National Capital" lays stress on the elasticity of his proposals. In our opinion, the very idea of a forced levy would rouse antipathy in the country, and we think that one involving a rate of 5*s*. in the pound and lasting for 25 years would be quite impracticable. Opposition would be intensified by the flat-rate character of the levy proposed. It would probably be necessary to resort to a progressive scheme, but this would raise administrative difficulties which might be great;

moreover, if the yield were to be equivalent to that produced by a flat rate of 5*s*., the rate might have to be very much higher for large fortunes.

A forced loan of a smaller amount would be easier to introduce, but its effect on revenue could only be equivalent to that of a comparatively slight addition to direct taxation, and at the best it would, in our opinion, not be worth while.

894. A forced loan, in so far as it carries a rate of interest below the general rate, is really a compound of taxation and of a loan on ordinarily remunerative terms. Such a financial expedient can in our view only be justified as an emergency measure, when great difficulty is experienced in getting taxes on the incomes or wealth of well-to-do people properly assessed and paid, and when there is not enough confidence for a voluntary loan to be floated successfully; in the circumstances of this country we can see no justification whatever for its adoption.

II.—ANNUAL TAX ON CAPITAL: INCREASED TAXATION OF INVESTMENT INCOME.

895. One of the features of the forced loan scheme which we have just considered is that the levy imposed under it would fall wholly on unearned or investment income. Thus it has a clear point of contact with the Capital Levy, in so far as it would be a method of redeeming debt at the expense of the owner of capital wealth, without raising any charge on current personal earnings. At the same time, the fact that it would be assessed on an income instead of on a capital base marks a vital distinction. The Capital Levy is concerned only with capital values, and disregards the income yield. Under the forced loan scheme, on the contrary, an equal amount would be payable on an investment income of £1,000, whether it were derived from gilt-edged securities worth over £20,000 or from speculative investments worth £10,000. The same is true of a straightforward tax on investment income. An annual tax based on the capital value of property, such as exists in certain countries, is closer in principle to the Capital Levy. We propose to consider briefly these two forms of tax—firstly, an annual tax on capital, and, secondly, a special weighting of the Income Tax on investment income.

896. *Annual tax on capital.*—In dealing with the Capital Levy, we have discussed the difficulties of capital valuation. An annual tax levied on a capital base would require not merely a single but a recurrent valuation, and it is clear at first sight that the task would be one of such magnitude as not to be worth while, unless a high yield was to be obtained. What we have to consider therefore is the question of incorporating a tax of considerable severity in the British taxation system. Whatever modifications might be made in the existing Income Tax, it

may be presumed that the total effect of the change would be to differentiate a good deal more widely than at present between earned and investment income.

897. From the point of view of equity, there is much to be said for making pure investment income carry a larger share than it does of annual taxation. We have explained, however (*para.* 356), that there are indefinite gradations between pure earned income and pure investment income, which it is impracticable to take into account for tax purposes. In particular, there is no means of distinguishing between income from the taxpayer's own savings and income from, e.g., inherited wealth. To tax investment income much more heavily than at present, while it would exact a contribution from the pure rentier more in accordance with his ability to pay, would involve unfairness and hardship to the taxpayer whose capital represented the fruits of his own effort and saving.

898. An annual tax levied on a capital base, while it would fall upon all investment income, would affect it with varying severity according to the security and general worth of its capital source. From the point of view of equity this is perhaps a special advantage in the tax. The Estate Duty, it is true, already makes some provision for this particular difference in ability to pay (*cf. para.* 476), but an annual tax would bring the distinction home to taxpayers during their lifetime.

899. The effect of the tax on savings would be double-edged If it enabled the standard rate of Income Tax to be lowered, the margin for saving would be increased both for the individual earner, and for the company (the capital tax being assumed not to apply to reserves). On the other hand, the heavier tax falling on investment income, besides impeding the accumulation of capital out of such income, would be a certain deterrent to the earner. Professor Pigou referred to the existing taxation of unearned income at a higher rate, and the existing death duties, as both being differential against saving, although, in view of the more or less automatic nature of a large part of the savings made, he did not think the check likely to be very great (*Ev.*, p. 41; *E. in C.*, 37 and Q. 660). The check would no doubt be accentuated by a considerable annual tax on capital. One special effect might be to give a stimulus to investment in the more risky class of industrials, inasmuch as £100 yielding £10 income would only pay the same capital tax as £100 yielding £5 income.

900. We conclude that in no respect is there a strong case in favour of introducing the tax into this country. A cogent reason against doing so is to be found in the administrative difficulties, which prove on examination to be very formidable. It is doubtful whether revaluation could be carried out annually in

Great Britain, on account of the large number of taxpayers. A triennial assessment would save expense, but taxpayers whose capital had shrunk in value would undoubtedly clamour for the appropriate reduction, while those whose capital had improved would escape additional tax. This would inevitably lead to inequalities and difficulties, which, recurring annually, would evoke dissatisfaction with, and great opposition to, the tax. Moreover, the requirement of returns of total capital, in addition to Income Tax returns, would in itself tend to exasperate many persons.

901. Finally, we may note that the system of taxation at the source cannot be applied to a capital tax, and that, in countries where the tax exists, the authorities are forced to base the assessments on the taxpayer's declarations. However strict the scrutiny, it is doubtful if the officials can adequately counteract the tendency to undervaluation, avoidance and evasion inherent in a system of self-assessment.

902. *Heavier Income Tax on investment income.*—The differentiation between earned and investment incomes might be increased in various ways. Lord Bradbury, who held that the process of taxing the rentier for debt interest or repayment "could with advantage be carried further, to the relief of the rewards of personal exertion and new enterprise" (*E. in C.*, 8), advocated, *inter alia*, a substantial increase in the allowance for earned income, the cost having to be met by raising the basic rates of tax. (*E. in C.*, 20.) He stated that he would favour alterations in the Income Tax, Super-tax, and death duties in pursuance of the same principle rather than a Capital Levy. (*E. in C.*, 29.)

903. Whether we consider a redistribution of the existing burden as between earned and investment income, or an addition to the existing burden, the addition being confined to investment income, we are met by the same difficulties in regard to equity and saving as in the case of an annual tax on capital. We may recall that in 1919-20 the Royal Commission on the Income Tax concluded, after mature deliberation, that the relief then granted in favour of earned income was too high. They proposed that the relief should consist of a deduction for assessment purposes of one-tenth of the earned income, subject to a maximum deduction of £200, and effect was given to this recommendation in the Finance Act, 1920 (*see Appendix* VIII). In the Finance Act, 1925, the measure of relief was increased from one-tenth of the earned income to one-sixth, subject to a maximum deduction of £250.

904. If it were intended to increase the present Income Tax burden in order to repay debt on a scale at all comparable with that aimed at by a Capital Levy, the addition would either have

to be exceedingly heavy for a short period or, if moderate, would have to be maintained over a very long period. The psychological effect in either case would be serious, and, so far as saving is concerned, we think that the placing of the entire additional burden on investment income would be a greater deterrent than a simple increase in the standard rate of tax all round. It is no doubt true, so far as the physical effect can be viewed apart from psychological reactions, that the additional tax on investment income would be beneficial to saving if it were all applied to debt redemption, and if the distribution of Government expenditure continued in other respects to be as at present. But this would be true of any annual form of taxation for debt redemption, and provides no argument for increasing the Income Tax (whether upon all income, or upon investment income only) rather than any other tax. It is clear that, given a definite scheme of expenditure, the question what form of tax will be best in relation to saving and enterprise can only depend on the way in which the taxpayer himself will be affected.

905. A heavy tax on investment income would be free from the great practical difficulties of an annual tax on capital, although the ease of administering it would, of course, depend on the form in which it might be imposed. We regard it as having, on the whole, less claim to consideration than a general increase of the Income Tax. The desirability or otherwise of such an increase must depend on Sinking Fund policy and on the consideration of other taxes.

III.—COMPOSITION FOR INCOME TAX.

906. In the course of the evidence given to us by Mr. Layton, reference was made to a suggestion which had originated with him, that the Income Tax payer might be invited to make a voluntary lump sum payment to the State in composition for part of his future tax liability. (Q. 2588.) Such advance payments would provide a certain fund for immediate debt redemption. We did not receive any further development of this idea from Mr. Layton, and we can therefore only examine it in the light of the proposals contained in his book, " The Budget of 1933 " (The Daily News, Ltd.).

After mentioning various strong objections to the Capital Levy, he points out that they would not apply to a voluntary payment out of capital. He suggests two ways in which the payer of Income Tax and Super-tax might be tempted to compound for these taxes. " One is that income tax payers might compound, say, for sixpence, a shilling, or one-and-sixpence in the pound on their income for a period of years or for life. This plan would have a certain speculative element about it, for if the taxpayer's income was increasing during the period he would be getting off lightly, whereas if his income were dwindling he would be paying more than on the income tax principle and the Treasury would

benefit. This speculative element might, indeed, be one of the attractions of the scheme to the public. The other device is that, by a capital payment made now, the taxpayer would be entitled to deduct a given fixed sum from his income tax payment for a given number of years. This plan would be much less speculative than the first, except that the taxpayer would benefit if the rate of interest in general fell. He would, in fact, capitalise his Income Tax payments on favourable terms."

907. The speculative element in the first scheme would be very large. If a man with £5,000 income in a particular year were to compound, on the basis of that income, for 6*d.* in the pound on his future income, or, in other words, if he were to pay a capital sum based on the present value of £125 per annum over a number of years, he would be compounding for a series of liabilities of unknown amount; if his income was liable to fluctuation, the series might, for instance, be :—

Year 1	...	£75 on income of	£3,000.
„ 2	...	£100 „ „	£4,000.
„ 3	...	£50 „ „	£2,000.
„ 4	...	£25 „ „	£1,000.
„ 5	...	nil on a loss.	

and so on; or it might begin very differently—

Year 1	...	£175 on income of	£7,000.
„ 2	...	£150 „ „	£6,000.
„ 3	...	£200 „ „	£8,000.
„ 4	...	£250 „ „	£10,000.
„ 5	...	£175 „ „	£7,000.

In very many cases, it would seem, the taxpayer could speculate on the practical certainty of an advance in fees or profits, and the State would lose heavily; it is just in these cases that the composition would be likely to be made.

908. The second scheme would appear to favour the richer taxpayer. It is tantamount to the purchase of an annuity for a term of years, the annuity being payable free of Income Tax and Super-tax. Let us suppose, for instance, that (on a basis of 4 per cent.) the offer were made of a deduction of £100 annually for 13 years, on payment down of £1,000; let us take the case of three taxpayers with incomes of £50,000, £5,000, and £1,500 who accept the offer, and let us suppose that the £1,000 capital sum paid down would have yielded £50 per annum to each of them, before deduction of Income Tax. When Income Tax and Super-tax liabilities are reckoned with, the £50 per annum would have been worth £25 net to the man with £50,000 income, £34 7s. 6d. net to the man with £5,000 income, and £40 net to the man with £1,500 income. In each case an annuity of the same net amount of £100 is received, although the prices paid are very different. This would clearly be inequitable, and unless the terms of the offer were fixed by reference to the case of the wealthy taxpayer (which would make the offer unattractive to everybody else), the revenue would suffer very great loss. The

only solution we can see would be to make the annuity liable to tax in the ordinary way. If this were done, then in the above example the man with £50,000 income would be allowed a deduction of £50 per annum, the man with £5,000 a deduction of £68 15*s.*, and the man with £1,500 a deduction of £80. The scheme, however, would then be indistinguishable from an ordinary annuity, payments of which might equally well be regarded by the taxpayer as a set-off against his tax liability. We cannot think that Mr. Layton would pursue either of his suggestions, on working out their implications.

909. A more detailed plan for the composition of Income Tax was sent us by Professor Lehfeldt of Johannesburg University, and is printed as Appendix IX to the Minutes of Evidence. His plan is that taxpayers, on reaching a certain age, say, 55, should be invited to compound for the whole of the payments of Income Tax (excluding Super-tax) to become due from them on unearned income for the remainder of their lives: if the system proved successful, it should afterwards be made compulsory. We may note the following points in the scheme:—

(i) The composition would be speculative in several respects. As Professor Lehfeldt indicates, the taxpayer who had compounded on the basis of his Income Tax liability in a given year would lose by any subsequent reduction in the rate of tax, and would gain by any expansion in the amount of his income. A further element of speculation is involved in the calculation of the capital sum by reference to life expectation: while men who reach the age of 55 may, on the average, die in 13·78 years, the individual will only occasionally conform to the average.

(ii) The scheme is limited to older people, "because at earlier ages men are earning freely and adding to their fortunes, so that to guarantee them immunity from taxation will deprive the Treasury of access to too large an amount of new wealth" (*para.* 6). This provision would fail of its object: it is precisely the older people whose fortunes often accumulate the most rapidly, as the Estate Duty statistics of age and wealth reveal. Men continue to earn freely till long after the age of 55, and the wealthy, even after they retire, may save very large sums out of the superfluity of their income over their requirements. The revenue would, therefore, be certain to lose very seriously.

(iii) It is proposed that, while increments of income due to the taxpayer's own efforts should be immune from taxation, the immunity should not extend to income derived from bequests (*para.* 9). Professor Lehfeldt thinks it should not be difficult to make this exception, but it is not clear how income from a bequest could continue to be identified after the monies had been merged in the general property of the taxpayer. Fresh composition would, apparently, be the only remedy.

(iv) The scheme would give many opportunities for evasion. On approaching the age of 55, for instance, a man would naturally be tempted to invest largely in non-income producing assets: after compounding for all future Income Tax and Super-tax, he could sell the assets and enjoy a tax-free income from them.

(v) It is suggested that the unearned income should be capitalised "at a rate of interest to be specified, say, 4½ per cent." (*para.* 7). Apparently, then, all income, whether derived from Government securities or from shares in a gold mine, would be capitalised at the same rate. This would obviously be inequitable. Here, again, it would pay the individual on the threshold of 55 to put all his money into gilt-edged securities, and, after having compounded, to re-invest in stocks giving a higher return.

(vi) If the scheme were voluntary, it would have many uncertainties and inequities, but it would, perhaps, be the taxpayer's responsibility, if he chose to gamble. If the scheme were compulsory, the Government would be responsible for inflicting hardships which could not be justified.

910. Apart from any particular scheme, we think it undesirable in principle that a gambling element—upsetting the canon of ability to pay—should be introduced into tax liabilities. We do not think it necessary to examine the administrative aspects of tax composition, but it seems clear that it would give rise to some friction, since the lucky gamblers would always be a cause of irritation to the unlucky. Further, the uncertainty and fluctuations in the amounts tendered would probably be troublesome to the Treasury.

911. Composition for annual taxes would, no doubt, provide a certain fund at once for debt redemption. But, as against any reduction effected in debt charges, there would be a reduction in receipts from the taxes which were subject to composition, and apart from considerations of price level there would be no advantage, in the long run, unless the terms of composition were so favourable to the State as to offer little attraction to the taxpayer. Under any voluntary scheme we think the result would be a loss in taxes to the State.

IV.—A FLAT-RATE TAX ON PRODUCTION, SUGGESTED BY MR. P. D. LEAKE.

912. In evidence before us Mr. P. D. Leake advocated a flat-rate tax on production, ultimately to be "of a percentage sufficient to raise the whole amount necessary for national revenue purposes" (Q. 4670). He afterwards submitted a summary, explaining his proposals in considerable detail, which will be found printed at the end of his oral evidence (*Ev. p.* 340). It is not our intention to discuss the proposals at great length, since they are bound up with a view of existing taxation which

is radically at variance with our own, as fully expressed in this Report, and since, moreover, they are open to a few broad objections which appear to us to be quite fatal. Mr. Leake regards progressive taxation as inherently vicious. In his view the principle of ability to pay is self-defeating (Q. 4734) : " the employers' disproportionate burden of progressive taxation " enters into the cost borne by them incidental to production, and therefore maintains high prices, which are detrimental to the wage-earning class (*Ev.*, p. 333 ; *E. in C.* 24) ; progressive taxation " is already acting disastrously in this country upon the well-being of wage-earners and others in receipt of small incomes." (*Ev.*, p. 332 ; *E. in C.* 17.) On these points we may refer to our Section dealing with the Incidence of the Income Tax, where we have given detailed reasons for our conclusion that the tax is not passed on like an indirect tax in prices to the consumer. In regard to progressive taxation as such, we have expressed our approval of the principle (*see especially para.* 330 *et seq.*), while recognising the dangers of carrying progression too far.

913. As regards some of the more general effects on saving and enterprise, our difference with Mr. Leake is rather one of degree. We agree that the highly progressive taxes have exercised a check, but we do not consider that they have been nearly so destructive as he suggests.

914. Mr. Leake's proposal is that a tax should be levied at the source on the annual national production, employers being charged on the total produce of their own efforts and of the labour and capital associated with them. Thus, when levied in respect of industrial business, it would be assessed on the total fund comprising salaries, wages, rents, interest on borrowed capital, and profits. " We deduct from the sales the amount of the purchases, expired capital outlay, or depreciation of plant, and all outside expenses like railway carriage, postage, and services received from other undertakings, and the difference will be found to be production." (Q. 4731.) The tax would be levied, not only on all business employers, but also on professional men and all classes of independent workers, the same principles of assessment being followed, so far as applicable. It would also be deducted from all interest on British Government and Municipal Securities. Lands, houses and personal belongings would come within assessment. (*Ev.*, *p.* 342, *paras.* 11-13.) While Mr. Leake discusses his tax largely on the basis of a 10 per cent. rate, which he thinks would probably be enough to supersede the Income Tax, Super-tax and death duties (Q. 4671), he suggests that " as a beginning, a production tax of 2½ per cent., or 6*d.* in the £ only, might be applied, simultaneously with some further reduction of the maximum rates of Income Tax and Super-tax " ; he estimates the yield of the 2½ per cent. tax at £75 millions. (*Ev.*, *p.* 343 ; *paras.* 20-21.)

915. A question of prime importance is how the taxed production of a business—i.e., the total fund as described above, minus the tax paid—would be distributed by the employer. "In the case of fixed contractual payments, under such heads as rent, interest, &c., the production tax of, say, 10 per cent. would be specifically deducted, and the net amount only debited to the Profit and Loss Account." (*Ev., p.* 341; *para.* 4.) The crux lies in the treatment of wages. Is the 10 per cent. to be borne by the employer or is it, in whole or in part, to be deducted from wages? Mr. Leake relies on a just division, but we find his tentative pronouncement most unsatisfying. "It seems probable that whether, and to what extent, the employer will find it necessary immediately to reduce the shares of taxed production paid in the forms of wages and salaries, will depend upon the circumstances. It may be that any reduction in the rate of wages and salaries will coincide with, or perhaps may actually follow the gradual fall in prices and the cost of living, together with the increase in opportunities of employment, which will result from the gradual release of employers from the present crushing burden of progressive taxation." (*Ev., p.* 340; *para.* 1.) Just before this passage Mr. Leake remarks that the amount of the production tax may or may not be greater than the amount paid by the employer under the present Income Tax. So far as we can see, this must depend mainly on the relation between the wages bill and the net trading profit in the industry concerned. In certain cases, e.g., in finishing trades, where relatively small numbers are employed, the production tax might be the less heavy. Over industry as a whole, however, wages constitute the bulk of the costs, the bill being heaviest in the great basic industries, coal, steel and iron, textiles, etc. Where large numbers are employed, the burden of a production tax of 10 per cent. would normally (unless very high profits were being made) be much larger in amount than that of the present direct taxes, apart from its difference in kind as a tax entering directly into the costs of production. It is difficult therefore to divine how the release from "the present crushing burden" could lead to prices falling either before, or even at the same time as, a fall in wages. It seems beyond question that, unless employers were to put up prices, they would, over a very large area of employment, have no option but to reduce wages at once, often to an extent commensurate with the tax. Whether, after an interval of time, there would be any fall in prices is at least problematical. The prospect of wages being forced down appears to be envisaged in the section of Mr. Leake's summary suggesting a "method of dealing with annual losses." Relief from the tax may, he concedes, be necessary in times of sustained adversity to certain industries carrying heavy labour bills; but in order to get relief on the ground that, after payment of wages and salaries, the tax does not leave a reasonable margin for the other co-operators, it would have to be shown "that the employers have paid no

more to the wage-earners and salary-earners than must be reasonably regarded as minimum payments necessary for subsistence " (*para.* 8).

916. Logically, it would seem consistent with the production tax scheme that the full 10 per cent. (or whatever the percentage might be) should be deducted from the wages, however low they might be. The object of the scheme is, after all, precisely to get rid of progression, and if the employer were to bear the whole tax or much more than his proportionate share, and the wage-earners were completely or almost completely to escape, effective progression would still remain, though of a most haphazard nature. Moreover, independent workers are intended to suffer the tax without any exemption for subsistence, and it is not clear why there should be any different treatment for wage-earners.

917. We think that, while some employers would attempt to deduct the tax from wages, very many would regard such a course as impracticable, and would pursue the alternative course of charging higher prices in order to shift the incidence of the tax. There would, we think, be immediate confusion in prices, out of which an increase in the general level would soon emerge. This would lead to demands for higher wages and to acute labour trouble and disturbance. The production tax, being a tax which, unlike the Income Tax, would enter into costs and which, unlike the Income Tax, would generally affect employers of labour, whether making a profit or not, would naturally tend to be passed on in prices to the consumer. Instead of remedying an evil wrongly imputed to the Income Tax, the production tax would itself induce that evil.

918. We conclude that, so far as the scheme might succeed in laying the burden of taxation proportionately on all incomes irrespective of size, it would be gravely inequitable, and would be a retrograde measure, undoing the whole advance that has been made in the science of taxation, particularly in the last 20 years; incidentally, if the tax were merely substituted for Income Tax, Super-tax and death duties, and the present indirect duties continued in force, the tax-system as a whole would be actually regressive, and exceedingly damaging to the workers' standard of living.

919. So far as employers failed to pass on the tax appropriate to wages, either by means of lower wages or higher prices, a burden of large and indefinite amount would be borne by industry, the weight of the burden having no determinate relation to the profit, and the larger employer of labour being the more severely penalised. If our industries in competition with foreign countries were to be saved from a new and very severe handicap, it would be necessary to allow generous drawbacks on export, and a duty would have to be imposed on all imports as an equalising tariff.

920. The tax would be inequitable not only as between individuals, but also as between one business and another. It would violently upset price-levels and wage-levels, and there would be a period of most injurious friction before any sort of equilibrium could be re-established. It is difficult to conceive a system that would be more harmful to the country.

V.—PROFESSOR RIGNANO'S DEATH DUTIES SCHEME.

921. The central feature of Professor Rignano's full plan, viewed simply as a method of taxation, is that it seeks to differentiate between wealth due to the effort and saving of the testator, and wealth which he has received by inheritance or gift, either at one remove or at two removes from the original saver. "Once the estate of the testator was thus quantitatively divided, the nation would not levy on the portion due to his labour and thrift any higher duties than it imposes to-day. On the portion which the deceased inherited directly from his father the nation would make a much heavier levy, say 50 per cent. On the portion which came to him from his grandfather through the medium of his father, there would be laid a very heavy tax, possibly 100 per cent."* As remarked by Professor Cannan (Q. 827), the proposal has been rather prejudiced from a purely fiscal point of view by its avowed social and political objects. It was put forward by Professor Rignano as "the sole way to achieve an effective and gradual nationalisation of private capital without injuring the delicate mechanism of economic production."† It can, though perhaps with some difficulty, be separated from this background and examined as a method of raising revenue for debt redemption, especially by the tests (*a*) of practicability, (*b*) of equity, and (*c*) of the effect on savings.

922. The form of the levy is not rigidly fixed, but the outline given above—existing rates on the first transfer of property from the original saver, 50 per cent. of the balance on the second transfer, and confiscation of the remainder on the third transfer—represents what is known as the maximum project. There is also a minimum project, less clearly defined, which, we understand, would only distinguish two transfers, and would always stop short of confiscation; a lower rate of duty would be levied on the part of an estate due to the savings of the decedent, and a higher rate on the part which he might have inherited. It will be clear that a scheme of this kind, if practicable at all, would be very elastic as regards the particular rates of duty which might be chosen.

923. In general, though with possible exceptions which we note in paragraph 925, no account would be taken under the Rignano scheme of the history of inherited property during the

* *The Social Significance of Death Duties.* Adapted from Dr. Shultz's translation by Sir Josiah Stamp, G.B.E., D.Sc. (Noel Douglas), pp. 38–9.

† Ibid. p. 50.

lifetime of the heir. The savings of the heir would be measured simply by the excess of his net estate at death over the amounts which he had received by inheritance or gift. For example, " if someone has inherited £60,000, if he dissipates this and later accumulates £100,000, the nation has no alternative but to consider the first £60,000 as representing the inherited property."*

924. *Practicability.*—We print, as Appendix XXVI, a memorandum which we received from the Board of Inland Revenue on the practical aspect of the proposal. The Board, addressing themselves to the maximum project, indicate that prolonged enquiry would be needed in order to determine whether a scheme of the kind could be put into effective operation in this country, but that on a first examination, and subject to certain important considerations, it would not seem impracticable (*para.* 4). Elaborate and costly records would be necessary (*paras.* 4 (i), 5 and 6). The tracing of gifts would be particularly difficulty and, even with special provisions and with drastic penalties for concealment, the incentive to, and the opportunities for, evasion would be considerable (*paras.* 4 (iii) and 7). The existing system of settlements and trusts would have to be largely modified (*paras.* 4 (iv) and 8). Even if, in all the conditions required, the scheme could be worked practically in this country—which is " perhaps doubtful " (*para.* 9)—it " could not in its initial stages be fully and effectively administered so as to secure a correct assessment and equality as between one taxpayer and another. Probably it would only be after the tax had been in operation for a considerable period, say, two generations, and full and elaborate records had been accumulated that it could be anticipated that the administration of the tax would approximate to the standard prevailing in the case of the other main direct taxes " (*para.* 4 (ii)). Sir Richard Hopkins in his oral evidence pointed to the extraordinary difficulties in the full Rignano scheme. (Q. 9150.) He added that the practicability would be much greater if there were only two rates, but that it must largely depend, in a great scheme of this kind, on the attitude of the taxpayers. (Q. 9154-8.)

925. *Equity.*—From the point of view of theoretical equity the distinction between wealth saved by the testator and wealth inherited by him, or received by way of gift, is one which might well enter in some degree into the graduation of the death duties. At the same time it has yet to be shown how it could be made to work fairly in practice. If the savings of the testator were to be measured simply by taking the excess of the net value of his property at death over the net value of what he had received by gift or bequest in the course of his life, without any allowance for appreciation or depreciation of the property so received, glaring inequalities would be found to

* *The Social Significance of Death Duties*, pp. 70–1.

result. Some of these might no doubt be modified. Professor Rignano himself recognises that it might be necessary to provide for alterations in the general value of money by a system of index numbers.* But alterations in the general value of money and in the general rate of interest are only the beginning of the trouble. The individual who comes into an estate does not receive an infinitesimal share of every kind of property; he receives certain particular stocks, etc., the value of which may go up or down independently of any average represented by a general index number; moreover, he may change over at any time into other investments or forms of property. For example, *A* and *B* each inherit property in the same year worth £50,000, and each lives to enjoy the property for an equal period. *A* preserves his capital intact and, although he does not work or save, his property doubles in value, while (according to the index which we may suppose to be applied) general values increase 50 per cent.; *B* realises his inheritance and puts half the proceeds into a business which he is just starting, but, being unlucky with his new investments and suffering losses in the early years of his business, he only manages, by dint of hard work and saving, to leave a property worth £75,000. While a quarter of *A's* estate (£100,000 – £75,000) would be deemed to represent his own savings and would, therefore, be taxed at the lower rate, the whole of *B's* estate would be treated as inherited.

926. We do not see how it would be possible to avoid inequity in the working of the scheme as hitherto formulated. Professor Rignano concedes that "it would always be possible to introduce statutory exceptions for cases where the inherited estate might be lost through fortuitous circumstances or *force majeure*." "However," he adds, "a competent tribunal would have to pass upon such cases, and closely check and limit them, in order that the entire significance of the reform should not be lost."† In our opinion, it would be extremely difficult to draw the line, if exceptions were once admitted; there would be constant appeals for new classes of statutory relief and for extra-statutory concessions, and these would very greatly embarrass the task of administration. The problems of equity would be serious, even if a modified form of the scheme were introduced. Under the "maximum" project they would be intensified.

927. *Effect on savings.*—Professor Rignano is confident that his scheme would stimulate thrift, since "as regards one's own children, every sum saved by the heir of a given estate would come to have, in his eyes, *a much greater value, even three or four times greater, than the sum he had himself inherited.*"‡ Before the scheme in any form could be really beneficial to

* *The Social Significance of Death Duties*, pp. 81–2, *cf.* pp. 61–2.
† Ibid, p. 91.
‡ Ibid. p. 39.

savings, we think it would have to win the willing acceptance of the taxpayer. Even then it would be likely to set up a variety of tendencies. An owner of inherited property which was threatened with a high rate of duty or with extinction on his death would very often be impelled to work and save; in the normal case, the comparatively low rate on his own savings would be a considerable incentive, and the prospect that those savings in their turn would suffer a heavier rate on the death of his heir would not be seriously repressive. On the other hand, the owner of inherited property might be drawn to speculative investment, since capital accumulated by speculation would be taxed at the lower rate just as much as any other savings; again, he might be strongly tempted to evade the duty, especially by means of gifts which, *prima facie*, it would be very hard to check; finally, he might be induced to squander the capital, especially if his children or other prospective beneficiaries were already flourishing in business, etc., on their own account. It is arguable, however, that, *if the scheme could be introduced in a form commending it to the taxpayer*, it would on balance exercise a beneficial influence on work and saving. Any immediate effect in this direction might be increased if the higher rates at the second or third transmission enabled lower rates than those now existing to be charged on the first transmission.

928. *Conclusion.*—The principle of the Rignano scheme—differentiation between saved and inherited wealth—has not yet been embodied in a form promising reasonably fair treatment to the individual taxpayer, while the administrative problems are very formidable and the risk of evasion is serious. Some of us, however, find the principle in itself attractive, and think it possible, from such consideration as we have been able to give to the idea, that it may in course of time have useful developments and enable some improvement to be effected in the existing death duties system. But we should view with disfavour any scheme which involved the Revenue in concern or interference with the conduct and maintenance of capital resources during the lifetime of their owner.

We may add that the full yield of the extra duty would only gradually be realised, since it would not begin to be charged until the second passing of any property after the date when the scheme had been introduced. It would, therefore, be some time before the scheme could materially assist in the reduction of debt.

VI.—A VARIANT ON PROFESSOR RIGNANO'S SCHEME SUGGESTED BY DR. DALTON.

929. A variant on the Rignano scheme was suggested to us by Dr. Dalton, its object being to assist in debt reduction. (*Ev., p.* 396; *E. in C.*, 19-20; and Qs. 5545-5553.) His proposal was to impose upon the net amount of wealth received by the beneficiary, after the ordinary duties had been paid, an

additional or supplementary charge at a fixed rate. This additional charge would be payable in either.

(*a*) cash,
(*b*) Government securities, or
(*c*) other approved securities,

or in any other particular form that might be approved. In return for this additional charge, the beneficiary would receive from the State a terminable annuity, the value of which would apparently be based upon the annual value of the securities, etc., at the date when they were due to be paid over to the State; and the annuity to be paid by the State would apparently be terminable with the beneficiary's life, or would run for a fixed term of years. The result would be that " so far as immediate income was concerned, the inheritors would not lose anything, but there would be a time-limit set. They would be holding a wasting asset in place of a permanent source of income." (Q. 5545.)

930. We may first consider the relation of the proposal to the Rignano scheme. Under the Rignano scheme an extra burden of duty is imposed at the second transmission, and does not affect the amount of property passing at the first. Under Dr. Dalton's proposal the corresponding extra duty is taken at the first transmission, and reduces the amount of capital wealth in the hands of the beneficiary. It is true that the beneficiary does not lose in immediate income, but the capital value of his annuity is less (at least, generally—*Ev.*, *p.* 396; *E. in C.*, 19) than that of the property he has handed over Thus the extra burden is imposed on the first transmission, and the distinction made by the Rignano scheme between saved and inherited wealth is blurred. In brief, while Dr. Dalton, by taking the extra duty at once, avoids certain flaws in the Rignano scheme, and especially its lack of adaptation to changing values (*cf. para.* 925), it appears to us that, in doing so, he sacrifices much of its essential character.

931. As regards practicability, we understand from the Board of Inland Revenue that, so far as they are concerned—i.e., in the matter of collection—there would be no difficulty, if the proposal were limited to benefits taken absolutely under the will or intestacy of a deceased person; if, however, it extended to benefits under *inter vivos* dispositions and to life interests, difficult legal and administrative questions would arise. From the point of view of the Treasury, Sir O. E. Niemeyer stated that the proposed method of paying the additional tax, which might be in securities or even in land, would mean " considerable administrative difficulties and would be likely to land the State in the end in a loss, because it has got to take a risk on the securities and has to take a risk on the selling of the land." (Q. 8820.)

932. In effect, the transaction between the State and the beneficiary would be a mixture of two things, (i) a death duty,

and (ii) the purchase and sale of an annuity for a certain period on ordinary terms. Dr. Dalton claims that inheritors " would be stimulated, by the prospect of the annuities running out, to work and save in order to make good the prospective loss of income." (*Ev., p.* 396; *E. in C.*, 20.) We doubt whether this claim is well-founded. The prudent man, it is true, would not regard the whole of the annuity as income; but it is likely that in many cases he would be content to get back into the same position as if he had merely been subjected to a direct capital tax equivalent to the burden imposed under the scheme. Frequently, in fact, he might achieve this object at once by selling his annuity (*see, however, next paragraph*). The improvident man, on the other hand, would probably treat the annuity purely as income; while capital, labelled as such, would have some sanctity in his eyes, it is likely that an annuity would only be taken by him as an excuse to spend.

933. A definite disadvantage of the proposal is that it would force upon the taxpayer a type of investment which experience has shown to be generally unpopular. The market value of the annuity would be considerably less than its value according to the tables. The scheme would therefore tend to entail a heavier burden on the taxpayer than a straightforward tax, actuarially equivalent.

934. Finally, it appears that the scheme would not begin to reduce the amount to be provided by the State for debt charges until the first annuities had run out. We endorse the conclusion of Sir O. E. Niemeyer, which was expressed as follows: " I think I should sum up my view on that in this way; that I do not see any very great advantage in this plan, and it seems to me to have the disadvantages as compared with an ordinary tax raised for the same purpose, that in the first place you get less immediate contribution to debt, and in the second place you get it in a less convenient form, because part of it is in land or securities, and that from the point of view of the beneficiaries the burden on them is probably heavier than the advantage that comes to the State." (Q. 8821.)

VII.—MR. J. ST. LOE STRACHEY'S PROPOSAL FOR CONVERTING DEBT INTO TERMINABLE ANNUITIES.

935. Mr. J. St. Loe Strachey gave evidence before us in support of a proposal to convert the debt, as and when opportunity offered, into terminable annuities running for a period of 100 years. He regarded the present Sinking Fund as involving too heavy a burden on the present generation, and put forward his scheme as one which " is automatic in its action and yet does not impose an intolerable burden on the men and women of the present for the benefit of the men and women of the future." (*E. in C.*: 9.)

936. The procedure which Mr. Strachey proposed was that, upon the maturity of any existing loan, the Government should offer the debt-holder a terminable annuity for 100 years, adding to the rate of interest such further sum as would produce £100 100 years hence. This addition would be a virtual Sinking Fund, but the yearly burden would, he estimated, be only some £6 millions as against the present £50 millions. In order to make it clear that the State was keeping complete faith with the national creditor, he thought it might be well still to offer the alternative of a perpetual bond, an appeal being made, however, to debt-holders to take the terminable annuity. Further, he proposed that a "Sinking Fund Commission" should be set up to undertake the work of founding a Sinking Fund for those debt-holders who were dissatisfied with the arrangement, the additional interest being paid direct to those Commissioners.

937. In the course of his oral evidence, Mr. Strachey admitted that, economically, his plan was equivalent to the creation by the State of a Sinking Fund to redeem the debt in 100 years. Politically, however, he considered his scheme very much the better, since it provided, in his view, a Sinking Fund which could never be raided. (Q. 7741.)

938. With many points which might be argued on Mr. Strachey's suggestion we deal in other parts of our Report. As will be seen later, we do not agree with his view that the present rate of repayment is too rapid. We think also that he stresses too much the perpetual nature of funded debt; in all issues in this country an option of repayment has been reserved by the State, and in the case of the 3½ per cent. Conversion Loan there is, in addition, a Sinking Fund which must operate for a considerable period. Apart from the more general considerations, however, we do not think that in practice it would be possible to convert a very large proportion of the debt into terminable annuities of 100 years duration. That form of investment appeals only to a limited area of investors, and it would certainly not be attractive to many of the classes by whom debt is now held. To force any large amount of annuities upon investors would in all probability require the offer of excessive terms of interest.

939. The scheme would in any event stabilise the rate of interest on the debt for a very long period ahead, since it is not apparently contemplated that the Government should reserve an option to redeem the annuities at any intermediate date. It is true that Mr. Strachey contemplates that at the end of, say, 70 years, "it would be extremely easy to deal with the annuities in such a way as to reduce the burden of interest. Large sums could be raised to get an extension of, say, another 20 years, just as is done in the case of Crown leaseholds." (*E. in C.*: 12.) The possibilities of future savings on the interest charge are,

however, much less, and are deferred to a much later date, than under the present method of issuing either redeemable loans or funded debt with an option to the Government to redeem after a specified date.

940. Mr. Strachey appears to recognise the limited demand for this type of investment by the proposal which he makes that the State should undertake the accumulation of the sinking fund portion of the annuity on behalf of investors who are dissatisfied with the offer. There are, however, difficulties in this expedient. The sinking fund portion of the annuity must clearly be assessed on an assumed rate of interest for the period of the annuity; Mr. Strachey took in his examples a 4 per cent. basis. While such a bargain is fair and reasonable in fixing the annuity, there can clearly be no certainty that in practice the assumed rate will actually be earned over a long period; it may vary either way. In these circumstances it seems to us difficult for the Government to undertake the investment proposed; it would undoubtedly give rise to an expectation, conceivably not to be realised, that the accumulation at the end of 100 years would be equal to the full capital value of the original debt converted. Complications would also arise under the arrangement owing to the assessment of the whole of the annuity to income taxation.

941. We are unable to regard Mr. Strachey's scheme as offering a practicable or desirable programme of debt redemption. He made, however, a subsidiary proposal that the Government should sell, in addition to life annuities and annuities for a fixed term, annuities which should run for life or for a fixed term of years, whichever should be the longer.

942. We understand that annuities for a fixed term are no longer issued by the Government, as the demand for many years was practically nil. Annuities for life issued by the Government appear to be an important proportion of the total of this class of business done in this country. At the same time, in relation to the total volume of debt, they represent an almost negligible capital value. Whether there is any scope for an extension of general annuity business as a means of easing conversion and reborrowing operations is doubtful. We recognise that questions of policy in regard to the scope of Government operations of this nature are involved, and we confine ourselves to suggesting that consideration might be given to the possibility of attaching to conversion offers an alternative of exchanging into annuities of, say, 40 to 50 years' duration. It resolves itself largely into a question whether the demand for a security of this type might be such as to enable the Government to issue on terms advantageous to itself. We ourselves are not very hopeful. It is to be noted, in any case, that under the present system of meeting the capital portion of annuities out of the Sinking Fund, no acceleration of the repayment of debt would result.

VIII.—PROPOSALS SUBMITTED BY MR. ALFRED HOARE FOR CONVERTING MATURING LOANS.

943. Mr. Alfred Hoare submitted to us a proposal for dealing with the debt maturing up to 1932. He suggested that the holders should, as their stock matured, be offered a new stock redeemable upon demand at any time by any holder, with interest to date, and bearing interest at the rate of 2½ per cent. free of Income Tax (and perhaps of Super-tax). The stock should similarly be redeemable by the Government, with or without the consent of the holder. Any holder not wishing to take the new stock would have the option of being repaid in cash. It was not an essential part of Mr. Hoare's scheme that the stock should be tax free, though he thought this would be rather more advantageous to the Government than to issue a stock at a higher rate subject to tax.

944. At the time that Mr. Hoare gave evidence (in June, 1924), the decision to return to the gold standard had not been taken, and Mr. Hoare stressed his view that an effective return was impossible until the large amount of debt falling due up to 1932 had been dealt with. While he was very doubtful whether that debt could be provided for except by the issue of new short-dated bonds, he submitted the suggestion set out above. In his view the present position was to a certain extent analogous, as regards the State and the fund holder, to that at the time of the Goschen conversion of Consols. He emphasised, however, the necessity for the Government to provide a substantial surplus to meet repayments under his proposal; with a surplus of £80 millions the country could, he thought, face a considerable inflation with impunity and gain considerably by reduction in interest.

945. In practice, Mr. Hoare anticipated that few holders would accept the new stock upon the maturity of bonds in 1925 (the evidence being given in 1924), and that provision for repayment would have to be made partly from the surplus and partly by Ways and Means Advances; in 1926, however, when no debt fell due, these advances would be repaid. The real difficulty would arise in 1927 and in 1928, but holders of maturing bonds would, he thought, feel that they had no option but to take the new stock, at any rate, in the first instance. If they decided to accept repayment instead, he considered that the result would be to increase the deposits of banks; there would be nothing to take the sums into industry, and the banks, unable to employ the money in the money market, would themselves take up the new stock. At the end of eight years, he contemplated that instead of £2,400 millions War Bonds, Treasury Bills and Savings Certificates, belonging partly to private owners but chiefly to banks and other large institutions, there would be £1,760 millions, all in the shape of stock repayable on demand, belonging in greater part (proportionately) than before to the banks and big institutions.

946. In view of the appeal which Mr. Hoare made to the precedent of the Goschen conversion of Consols, it is desirable to set out briefly the main differences distinguishing the conditions then prevailing from those at the present time. At the time of that conversion all the stocks dealt with stood above par; a *prima facie* case existed therefore for lowering the rate of interest, and this was strengthened by reference to the position of other first class securities. For instance, railway debentures had during the previous 10 years risen by about 23 per cent., while Consols had risen barely 6 per cent. The movements of other securities also afforded evidence that the Government was not deriving full advantage from the large increase which had taken place in the amount of capital seeking investment, and that British credit was not being turned to the best account. The primary reason was probably that the fear of conversion or redemption was depressing the price of Consols; it is to be noted that 3 per cent. Local Loans Stock, then irredeemable for 25 years, stood at a higher price than 3 per cent. Consols. All conditions pointed, therefore, to the likelihood that holders of Consols would for the most part be prepared to accept a lower rate of interest, rather than take repayment at a time when gilt-edged investment in any other direction would have yielded them terms similar to those offered under the conversion. Moreover, all the loans dealt with were in the form of annuities which the Government was under no obligation to redeem, although they possessed options to do so upon, in some cases, due notice being given. The amount of the Floating Debt was small and unlikely to hamper conversion operations.

947. We are unable to see any real parallel in the conditions of the present time. There is, in the case of the loans which Mr. Hoare has in view, a definite obligation upon the Government to repay at a set date, and the terms of any conversion offer must therefore depend upon the yield of alternative investments, of similar class, open to the investor. The investor will certainly not be content to accept, say, a 3½ per cent. stock so long as he can obtain a higher yield elsewhere, and the sole inducement which might lead to the acceptance of such an offer arises from the proposal that the new security should be redeemable on demand. It would, therefore, be held only by those who valued that right of repayment, and it would come into the money market, together with the remainder of the Floating Debt, to be held almost exclusively by banks and discount houses. Even to those holders it would be acceptable only so long as the rate on short money was as low as the rate on the new security.

The scheme is, in short, by a process involving very considerable risks of inflation, to turn a large part of the maturing debt into Floating Debt, and thus to reverse the whole policy pursued up to the present of funding debt as and when favourable opportunities occur. We have no hesitation in rejecting this proposal.

IX.—PROFESSOR A. L. BOWLEY'S SCHEME FOR VARYING THE AMOUNT APPLIED TO DEBT REDEMPTION IN ACCORDANCE WITH THE STATE OF EMPLOYMENT.

948. Professor Bowley placed before us his plan for the linking up of a policy of debt redemption with a policy for the diminution of unemployment. He assumed that periods of expansion and contraction of industrial activity follow one another with a certain regularity, and that it would be possible in each year to ascertain in what phase of the industrial cycle this country stood. He then argued that it was to the national advantage to redeem debt more rapidly in times of expansion, when the market value of Government loans would be relatively low, and capital was needed in industry. On the other hand, there was a need for expenditure to diminish unemployment in years of depression. Owing to the three years' average for Income Tax and other causes, movements in the receipts from taxation lagged behind movements in the industrial cycle; it was probable indeed that the amount available from taxation for debt redemption was nearly independent of the phase of the cycle.

949. Professor Bowley proposed that a constant sum should be set aside each year to be used either for debt redemption or for public works. Taking as an illustration an annual provision of £100 millions, he suggested that, over a period of eight years, this might be allotted as to £710 millions to debt redemption and as to £90 millions to public works. In the year of greatest trade expansion the whole £100 millions would be devoted to debt redemption; in the year of greatest depression about £55 millions would go to redemption and £45 millions to works. The works in question would be those on which public money would be spent in any case—such as buildings, docks, roads and loans to local authorities for construction—and the programme would be limited to those items which could be accelerated or postponed one, two, or three years without serious inconvenience. He estimated that as much as £11 millions annually could be administered in this way, and he anticipated that a sum of this magnitude would go far to equalise employment one year with another in that large group of labour (mainly, but not wholly, unskilled) employed in public works and works of construction. Professor Bowley emphasised that the policy was not one of additional expenditure or of making work for the unemployed, but only a systematic transference in time of expenditure normally incurred (*E. in C.*: 21).

950. In a paper on "The Regularisation of the Demand for Labour,"* to which we were referred by Professor Bowley for a wider discussion of his plan, we observe that an attempt has been made to meet the objection that employment is simply transferred from that for private to that for public purposes.

* Christian Order of Industry Series—5.

" If," says Professor Bowley, " additional rates or taxes were levied in order to spend them on public undertakings, the rate or tax payer would have less money to spend, and he would either employ fewer people directly or indirectly, or invest less in private enterprise, or leave less at the bank. With the partial exception of the last case, the transference would result in no additional employment. It is not, however, suggested that the works should be thus financed." It is then argued that, if the suggested adjustment of the use of the Sinking Fund were made, " in the good years the sums paid to the State's creditors would find their way into ordinary investment, at the period they were there wanted. In bad years, when capital is not in such demand, this source of supply would be checked." It appears, then, to be agreed by Professor Bowley that the imposition of additional taxation for carrying out work would only react on total employment in so far as it might result in the application to public works by the Government of sums which would otherwise have lain idle. No distinction appears to be drawn here between good and bad times; the inference is, we presume, that sums will only lie idle at a time of depression.

951. In considering this scheme it is necessary to pay some attention to the sources from which the types of work involved are at present financed. In an article in " *Is Unemployment Inevitable?* " Professor Bowley examines the pre-war allocation of expenditure which might come under his scheme. For the 10 years 1904-13 he shows the following annual average :—

	£
Expenditure by Local Authorities defrayed out of *loans*	21,637,000
Expenditure by Central Authorities and Public Bodies :—	
Railway Companies, etc.	9,743,000
Public works and buildings, post office telegraphs, etc.	3,047,000
	34,427,000

" To these sums," he adds, " are now to be added a considerable part of the yield of the Motor Vehicle Duties, estimated for 1923-24 at £13 millions. The former sums will presumably be increased in proportion to the increase in wages in the long run." In another article, in referring to the Motor Vehicle Duties, Professor Bowley indicates his view that the whole of the upkeep and construction of roads could not be concentrated in three out of eight years.

952. In the main it appears, therefore, that the works to be retarded or accelerated will be undertaken by bodies other than the Government, and that the finance for these works is at present provided by borrowing, either directly from market sources or to a limited extent from the Government through

the Local Loans Fund. The proposal appears thus to involve a departure from present practice, in some ways fundamental to the consideration of the scheme, in that the Government is to find, out of taxation in the first instance, the capital required for these special works. Indeed, Professor Bowley says that "the only possible way of influencing the amount of employment provided by Local Authorities . . . . is by exercise of the Central Government of its powers of compulsion, of making or withholding grants, of granting or refusing power to borrow, and, above all, of providing capital on easy terms at times when it is desirable on national grounds that public works should be set in hand."*

953. We think that the scheme can be most conveniently considered under three aspects :—

(*a*) How would employment be affected by the programme of *taxation* (on the collection side)?

(*b*) How would it be affected by the programme of *debt redemption*?

(*c*) How would it be affected by the programme of public works *expenditure*?

This may become clear, if we set out three possible alternative arrangements :—

(i) a fixed Sinking Fund; expenditure on public works undertaken, and the necessary taxation imposed or borrowing undertaken, as and when the occasion arises;

(ii) a fixed Sinking Fund; expenditure on public works deferred or accelerated, where possible, so as to fall in years of depression, and the necessary taxation imposed or borrowing undertaken in those years;

(iii) a fixed joint amount, for Sinking Fund and public works together; expenditure on public works regulated as in (ii), but the total sum involved being raised by taxation alone, spread evenly over all years.

(The Sinking Fund, while maintaining the same average, would be larger in years of good trade; expenditure on public works, while maintaining the same average, would be larger in years of depression.)

954. *Taxation programme.*—Professor Bowley suggests that about £11 millions per annum can be usefully transferred in time for public works expenditure. We have already stated that the bulk of this sum appears to relate to bodies other than the Government and to be financed at present by loan. With these points in mind, it would appear that, so far as taxation is concerned, the third alternative—that suggested by Professor Bowley—would throughout impose a heavier taxation burden than the second alternative. The second alternative would require in the year of greatest prosperity £11 millions less taxation than Professor Bowley's scheme; in the year of greatest

* *Is Unemployment Inevitable?* (p. 376).

depression, while it would require a larger total sum to be raised (by taxation and borrowing together), it would require no heavier taxation unless at least £11 millions were spent on *Government* works postponed or accelerated. On the figures given above, that does not seem a likely contingency.

A comparison with the first alternative—where works are carried out as and when needed—involves the same point. Clearly, the taxation would only reach the figure of Professor Bowley's scheme if the direct expenditure on Government works reached £11 millions in any year. (It is to be understood that we refer throughout to expenditure on those works regarded as transferable in time and not necessarily to the total expenditure of a capital nature.)

955. We have seen (*para.* 950) that Professor Bowley considers that additional taxation for public undertakings would have a very limited effect on employment. It is, we think, clear from the fact that his scheme involves a charge on taxation for loans to Local Authorities and others hitherto met by direct borrowing that it would mean additional taxation throughout. There would be a substitution of taxation for direct borrowing, and further, since the taxation would be spread evenly over all years, it would generally happen in years of depression that, as against the extra taxation for works (*cf. para.* 959), there would be a larger diminution in borrowing. In our view, the raising of £x millions, and still more of £x + y millions, by borrowing would be likely to set idle balances in motion to a greater extent than the raising of £x millions by taxation.

956. *Debt redemption programme.*—Looked at from the point of view of debt redemption, the fixed Sinking Fund would redeem more debt in years of depression and less in years of prosperity than Professor Bowley's scheme. On the other hand, if the rearrangement of works were actually in being, there would be an immediate outlet for the additional repayments in the borrowings necessary by Local Authorities and others to carry out the works; while Government debt would decrease, local debt would increase. Without the rearrangement of works and in the absence of that outlet there might, however, be a tendency for the money repaid to swell idle balances.

957. Up to this point it does not appear that Professor Bowley's scheme would have any marked advantages: considered in relation to the second alternative—which presumes a similar rearrangement of works—it seems indeed to be distinctly disadvantageous. So far as the effect is to accelerate, through heavier taxation, the repayment of debt in times of prosperity, this could equally be done without linking up the Sinking Fund with a scheme of public works.

958. *Expenditure programme.*—There remains the question of the effect of a rearrangement of public works expenditure,

which, in our view, is susceptible of quite independent treatment. That goes much beyond our province, and we can only allude to it in the briefest way.

959. The proposal is to meet the cost of works in part out of additional taxation, in part out of money which would otherwise, in the year concerned, be applied to debt redemption. In the year of greatest depression the £45 millions suggested will be made up of £11 millions taxation for works and £34 millions representing, in effect, the reborrowing of sums applied in earlier years (or to be applied in later years) to debt redemption. The additional expenditure on works is represented by £45 millions, less the sums that would otherwise have been raised by the Government through taxation, and by Local Authorities and others through loans under their normal programme.

We think that this process might tend to stimulate the internal flow of credit, by taking up balances which would otherwise lie idle or be invested abroad. This aspect, however, should not be unduly stressed. Other means exist for overcoming or lessening the stagnation of balances. Even if a low bank rate proved insufficient for the purpose, it seems probable that the purchase of securities by the central bank in the open market would be effective. The crucial question is whether the proposed regulation of public works expenditure would affect the *enterprise* of the country. It appears to us possible that in a period of trade depression the mere provision of credit, however abundant, may not do all that is necessary to set the industrial machine to work. Here we think that Professor Bowley's scheme, since it would not merely offer credit, but would also provide a programme of work, would have some effect in the direction of increasing enterprise and employment. This, however, is a general question which properly falls outside our terms of reference and we cannot undertake to gauge the extent to which the scheme, in this aspect, would affect employment.

960. In features of the scheme which more directly concern us we see considerable objections. While the same average amount of revenue would be applied to debt reduction, the amount so applied would vary from year to year, and we do not think the psychological effect would be so good as under a system where a definite sum is provided each year. The combination of the Sinking Fund for the debt with a fund for other expenditure would tend to obscure the situation.

But there is a more important objection. We think that, in making the amount of debt redemption depend on the amount of other expenditure under a particular head, the scheme would act as a standing temptation to divert revenue from debt redemption to other expenditure that might seem especially desirable. It would increase the risk of the Sinking Fund being raided.

961. On the practical side of the scheme there are obvious difficulties, which are, we think, fully recognised by Professor

Bowley. Not only must the time at which expenditure on public works is to be accelerated be gauged with accuracy, but the whole programme of works involved must be arranged beforehand in order that the scheme may be put into immediate operation at the appointed time. This involves not only an elaborate consideration of claims of relative urgency for works to be undertaken by a very large number of different bodies, but of the state of unemployment in particular industries. It does not by any means follow, for instance, that at a time of depression any benefit will be secured by accelerating building schemes. Wide considerations are involved which would, we think, be very difficult to anticipate in drawing up a programme of work.

962. It is to be noted also that difficulties might arise, unless a substantial addition were made to the Sinking Fund, from the fact that a large (and to some extent uncertain) part of the Sinking Fund is earmarked to particular securities.

963. From the point of view of the debt problem (which is our main interest in the scheme) we think the considerations are, on the whole, against its adoption ; the advantages to employment would require to be very marked to justify any disturbance of a clear-cut debt redemption policy, and it does not appear to us to be of the essence of the scheme that it should be financed by the central Government (except so far as its own works are concerned) rather than by the bodies directly concerned.

PART III.

DEBT REDEMPTION AND TAXATION : CONCLUSIONS.*

I.—DEBT REDEMPTION.

964. We have in the preceding part of our Report considered and rejected the proposal for a large immediate repayment of debt by means of a Capital Levy, and we have examined other schemes submitted to us for the redemption or conversion of debt and concluded that they are, upon various grounds, either impracticable or undesirable.

965. In the course of this examination we have dealt with arguments supporting particularly a policy of immediate or rapid debt repayment. It is necessary now to review the evidence put forward on the more general questions whether debt repayment should be undertaken, and at what rate it should proceed.

966. *Reasons for steady reduction.*—We may say at once that not one of our witnesses has suggested that it is unnecessary to make any provision for debt redemption. It is pertinent, therefore, in the first instance, to look at the reasons which have been advanced more particularly in support of a steady annual reduction in the debt. Apart from the general desirability of effecting some reduction in order that the burden upon posterity may not be too great, these reasons may be conveniently summarised as :—

(*a*) the maintenance and improvement of the national credit, particularly with a view to paving the way for future conversion operations;

(*b*) the desirability of reducing the debt in view of the possibility of a future national emergency requiring the State to incur further borrowing;

(*c*) the risk of the burden of the debt charge increasing beyond the present point, should the level of prices fall in the future.

967. The first two points are largely interconnected, since the main effect of the existence of a large debt at a time when further borrowings are needed would be to raise the interest rate against the Government. It was put to us by Professor Pigou that the terms upon which the Government can borrow, given general world conditions as to the demand for and supply of capital, " will depend—apart from expectations of changes in the value of money—on the confidence people have in the ability and willingness of the Government to honour any obligations that it may incur. Other things being equal, the existence of

* For conclusions on the burden of the debt and existing taxation, see pages 233–245.

a large National Debt to which no remunerative asset corresponds must weaken that confidence. Given the size of the National Debt, a consistently maintained policy of providing for the service of the debt (including the gradual reduction of the principal by means of a Sinking Fund) must strengthen confidence " (*Ev., p.* 39; *E. in C.*: 3).

968. Considerable stress was laid by Sir Felix Schuster upon the importance to the country of debt repayment through the Sinking Fund. Especially in bad times, he said, it provided the best means of maintaining confidence and keeping up the level of the quotations of Government securities, a point of particular importance in relation to the conversion of the debt to a lower level of interest (*Ev., p.* 9; *E. in C.*: 3). Mr. A. M. Samuel and several other witnesses expressed similar views.

969. On the other hand, Mr. Keynes, while agreeing that it was sound policy to repay a certain amount of debt each year, if possible, stressed his view that the power of the Treasury to reduce the rate of interest on the debt below the world rate of interest on first-class securities was very limited In the years immediately succeeding the War, he said, the rate of interest on the debt was probably above the true rate, and prudent finance had had its reward in bringing the rate down to somewhere near the true rate. But having achieved that, he thought not much more could be done. The rate could not be continuously forced down merely by paying off debt, irrespective of the rate of interest in the outside world. The most that could be done was to get into the situation of an absolutely prime borrower, never requiring to pay more than the international rate of interest as a prime borrower. That position, he suggested, had been practically achieved already, and the rate of interest on the debt in future, assuming reasonable prudence, would depend upon the general movement of the rate of interest rather than upon the particular policy of the Treasury (Q. 7607).

970. In our opinion, a consistent policy of providing sums for debt redemption must exercise an important effect in raising the level of the prices of Government securities and lowering the real yield of interest thereon, or in maintaining the level, should other factors tend to a general depression of security values. We are not prepared to accept the contention that the utmost benefit which can be achieved by this means has already been gained. In this connection we attach some importance to the effects of the great widening of the area of gilt-edged securities which took place during the War. In normal times, when investment in such securities is limited, more or less, to trustees who require to hold gilt-edged investments and to other persons with a special preference for them, there is, as the result of a persistent demand operating in a comparatively small area, a tendency for the interest yield on gilt-edged securities to fall considerably below that obtainable on other types of investment. The magnitude of the sums required for the prosecution of the

War made it necessary to appeal to a much wider class of investors who were influenced by motives other than a mere preference for gilt-edged securities. In the long run the tendency was to reduce the margin between the interest on gilt-edged securities and that obtainable on other holdings. The reduction of the volume of Government debt should, we think, operate to reverse this position and to raise the level of prices of Government securities relatively to those of other investments.

971. It is, of course, impossible to ignore that, as Mr. Keynes pointed out, limitations are imposed upon the fall of interest on Government securities by the world rate of interest. At the same time, some importance is, in our view, to be attached to the position of London as an international borrowing market, and, therefore, as one of the regulators of that rate of interest; any influences making for a lower interest level in this country should tend in the long run to be reflected in the world rate of interest. It is difficult, however, to picture such a free working of a world interest rate as would exclude a further betterment of Government borrowing rates in this country. Individual choice between investing abroad and at home is determined by many considerations, apart from the actual interest yield, and, amongst them, the steps taken to maintain the country's credit must be reckoned.

972. We would regard the points made by Mr. Keynes as more convincing if the debt of this country were wholly in funded form—in which event the movements of the rate of interest on Government loans would obviously be of less moment. But, in fact, large conversion or reborrowing operations must necessarily be undertaken within a comparatively short period. That factor introduces in itself a measure of instability in the values of Government loans. In such circumstances the " expectation " of the investor is of importance ; if he sees that debt repayment is being steadily made he will be influenced in his estimation of the future course of values and in his attitude to future conversion offers. At the same time, the amount of debt to be dealt with is, or may be, reduced, and the sums set free by repayment will probably return, in the first instance, for investment in the gilt-edged market (*cf. para.* 277). The particular conditions of the debt at the present time seem to us to indicate that, within the limits of the savings possible from conversions, there are substantial advantages to be gained by a policy of steady debt repayment.

973. Considerable emphasis has been laid by several witnesses upon the need for reducing debt because of the possibility that a future emergency, necessitating fresh borrowings, may arise. Professor Pigou, indeed, stated that, if it were not for the risk of future wars, he would be in no great hurry about repaying the debt by a Sinking Fund, but in view of that risk he thought the Sinking Fund should be large (*Ev., p.* 437 ; *E. in C.;* 6). Mr. Keynes attached little importance to this argument as a

test of the amount of debt which ought to be paid off, since the extent to which one could be armed against it in a short period by an increased Sinking Fund was very small (Q. 7571).

974. We think that sound finance requires this contingency to be taken into account. While a large debt would, in the event of fresh borrowing becoming necessary, be a grave disability in itself, a debt in regard to which no consistent policy of repayment had been taken would, we think, be still more serious. The very impossibility of foreseeing future needs for borrowing is in itself an argument for taking early measures steadily to redeem debt; it would clearly be of no avail to wait until the emergency had arisen. Moreover, the facilities for emergency taxation as well as for emergency borrowing are affected. The maintenance of a regular Sinking Fund would automatically make available a considerable revenue on its temporary suspension. Further, the decline in the interest charge, provided it had not already been made the occasion for other commitments, would leave a corresponding margin for expansion.

975. The third point—the risk of the burden of the debt increasing if the price level falls—we have reviewed in connection with the Capital Levy (*cf. paras.* 737-43). We conclude there that the evidence before us does not point to any very strong or definite movement in general prices such as would affect in any important degree the case for or against a levy. If we can rely upon the gold standard giving relative stability of prices, this is not a matter upon which too much immediate stress need be laid. As we point out in paragraph 860, the possibility has to be faced that any further emergency requiring large borrowings could not be financed without some considerable inflation; this, whatever its other results, would reduce the burden of old debts.

976. *Rate of reduction.*—Turning now to the evidence which was more definitely addressed to the rate at which debt redemption should proceed, we introduce at once the taxation aspect of the question, which to a large extent has been covered in our examination of the effects of taxation; we propose in the first instance to examine the strong views expressed by Mr. McKenna and Mr. Keynes regarding the results which may follow from a policy of rapid or fairly rapid repayment.

977. Mr. McKenna, who described himself as not an apostle of the present £50 millions,* much less of any addition (Q. 6797), held that repayment should proceed steadily but slowly, on account of the displacement of capital which it caused (Q. 1839). On that point he agreed that many things had to be taken into account. " You have to satisfy public opinion, you have psych-

* Throughout this Section we have referred to the present Sinking Fund as being £50 millions. In the Budget for the year 1926–27 the provision estimated for was increased to £60 millions in order to compensate for the deficit of the preceding year.

ology to consider; but if I were dealing purely in the abstract, my object would have been in the first place to have got my taxation down to a level which the country could afford without injury to trade—I don't mean afford conveniently, I am not wishing to pamper the taxpayer—but with sole regard to the welfare of industry. I think then I should ultimately have got a larger revenue, which would have enabled me to repay debt." (Q. 1842). His argument was that, though the transfer from taxpayer to debt-holder involved in the repayment of debt would increase the amount of savings by the amount of the taxation withdrawn from consumption, the high taxation required to carry out debt redemption on a large scale might so diminish the incentive to save as to result in a final net reduction in the supply of capital. But he attached even more importance to the quality of capital than to its quantity, and, basing his argument on the assumption that if a firm were making large profits and paying large sums in taxation it was evidence that the business was in competent hands, he stressed the dangers of transferring by heavy taxation, and particularly by graduated taxation, potential capital from highly efficient hands to less efficient hands. While the question was in every case one of degree, he considered that the ultimate effect of any great transfer of capital due to a big scheme of debt redemption must be seriously to impair the national prosperity. (*Ev.*, *p.* 132; *Ans.* 1 (*b*).)

978. Mr. Keynes' contention—also based upon the disturbance of ownership of potential capital—was that holders of debt who received repayment would probably prefer to reinvest in bonds of the gilt-edged type. If, on the other hand, money was left in the pockets of the taxpayer, there was no such presumption, and savings might find their outlet either in industry or in any other way. At a time when there was a heavy demand by gilt-edged borrowers, it might be a sound policy to repay internal debt, but in present conditions, he considered that a rapid repayment afforded an artificial stimulus to savings to flow into the channel of gilt-edged investments. (*Ev.*, *p.* 278; *E. in C.*, 3.) Once he had got a sufficient balance on the right side to satisfy the requirements of ordinary good finance, he would look to the criterion of the demand for savings in investments of the trustee type, rather than to any other criterion, in deciding how fast he would repay debt; he was clear that, if upwards of £100 millions of debt were repaid annually, it would place at the disposal of the gilt-edged market a larger part of the surplus of the community than was desirable. (Q. 3973.)

979. These contentions are mainly concerned with reactions upon the incentive to save, and with the results of diverting resources from taxpayer to debt holder, matters which we have considered at some length in earlier parts of our Report. On balance, we think taxation for debt repayment propitious to savings (*para.* 275). Clearly, however, there is a limit to this

advantage, since the taxpayer's expenditure cannot be indefinitely restricted, and there is a point beyond which any additional taxation will fall in increasing degree upon resources which he would have saved. At the same time, increased taxation will react more and more upon the volume of profits—and therefore upon possible savings—through the restriction of enterprise. We have attempted to show the area over which such a restriction is likely to operate; although the harmful effects of taxation in this respect are, we believe, generally exaggerated, we cannot but recognise the danger that any large increase of taxation would negative the beneficial results of applying the proceeds to debt redemption. We think there is force in Mr. McKenna's argument as relating to any big scheme of redemption, but hardly as relating to any moderate increase in the present programme.

980. On Mr. McKenna's main point—the change in the "quality" of capital—we have again examined the probable area of operation (*cf. para.* 421). Our conclusion is that this is a potential danger rather than one which has been widely realised, and we are of opinion that taxation would require to be increased very heavily to produce any really serious consequences on industry. In fact, whatever the first preference of a repaid debt holder may be, the cash, unless it is to lie idle, must ultimately reach a new investment. What that investment is depends on circumstances. Mr. Keynes' argument appears to us to assume that, because the first demand may be for gilt-edged investments, there will necessarily be an increase in the supply of that particular type. We doubt whether there would in fact be any artificial stimulus, and, so far as there is a natural demand, we are not prepared to regard it as harmful, the more particularly as in times of peace by far the greater part of such borrowings are for reproductive or directly beneficial undertakings. On the further contention that the result of repaying debt may be unduly to increase overseas borrowings, we would only say that, as other means exist by which such a tendency can be corrected, we do not think it is a factor which should be taken as seriously bearing on the policy to be adopted towards debt repayment.

981. A further aspect of debt redemption which has been mentioned in evidence before us is the effect of repayment upon the volume of credit available to trade and other borrowers. The position, as we see it, is that the Government through taxation acquire command of a certain proportion of purchasing power and transfer this to a former debt holder. If the holder is an individual, little effect need be anticipated. He may, of course, use it to repay a bank advance; in that case the credit is available for another borrower, and no reduction need take place unless general conditions are such as would in any event lead to a reduction in the demand for credit. The position of borrowers in regard to the deposit of Government securities as collateral has been discussed in connection with the Capital Levy (*para.* 778

et seq.); obviously, it is a question of little importance in connection with more gradual repayment of debt.

982. The effects of repayment of the debt holdings of banks, while more complicated, are not necessarily different in the result. The combined operation of taxation and repayment improves the banks' ratio of cash to deposits. The ability of the bank to lend is thereby improved in precisely the same way as it would be if the bank were to sell in the market, but the observance of conventional proportions between the various assets of the bank will probably restore the status quo. Temporary movements may obscure the position; as Mr. McKenna observed, the first outlet sought by the banks may be to lend to the money market and other borrowers in the habit of borrowing from the Bank of England, and thus to lead to the repayment of loans to that Bank and a reduction of the cash balances of the banks generally. (Q. 1941.) But, broadly, it appears to us that, while the occasion of debt repayment would be a convenient opportunity to effect a reduction of the credit basis, if on general grounds that were deemed desirable, there is nothing inherent in repayment which would lead to any restrictions.

983. One qualification has to be made on this point. Mr. Beaumont Pease indicated that, if a part of the resources of banks is held in the form of Treasury Bills, the banks are able to lend more readily than when resources are locked up in less easily realisable long-term investments. (*E. in C.*, 6.) The same point was referred to by the Federation of British Industries. (*E. in C.*, 40.) The repayment of Bills and short-term loans may, therefore, lead to the adoption of a somewhat higher ratio of cash to deposits and thus tend to some restriction in advances to borrowers.

984. With debt repayment upon any scale which is within the capacity of annual taxation, we think the effects upon the demand for credit and the ability to provide it need be of little importance. The whole matter is referable in the long run to the general policy which is being pursued in regard to the regulation of credit through adjustments of the Bank rate and otherwise.

985. The evidence which we have summarised and reviewed above may be taken as generally indicative of the main issues raised before us regarding the dangers of too rapid a redemption policy. We do not think that it supports the view that a rate of redemption such as the present is dangerous and should not be exceeded.

986. The possibility of arriving at a rough formula by which to regulate the rate of debt redemption was suggested by the several bodies of Accountants. They considered that the amount applied to debt repayment should at no time exceed the amount of the annual savings of the nation which remained after provid-

ing for the necessary expenses of Government, including interest on the debt and sufficient accumulation of capital (*a*) to provide for growth of population, (*b*) to replace capital lost in the War, (*c*) to provide for new undertakings, and (*d*) to permit improvements in the standard of living (*E. in C.*, 52, *and* 57).

987. A somewhat similar suggestion was made by the Federation of British Industries, who held that " the maintenance and development of national production and trade in order to meet the needs of an increasing population should be regarded as the principal objective, and that only that portion of the national income which is left after ample provision has been made for this object should be regarded as available for current expenditure or debt reduction " (*E. in C.*; 69). Mr. A. M. Samuel also expressed similar views.

988. The difficulties of expressing in figures any formula of the nature suggested are obvious, and may be illustrated to some extent by our discussion of Mr. Samuel's views in paragraphs 696-700 : the attempt to make debt repayment or other expenditure conditional upon the satisfaction of such indefinite and uncertain prior claims as are indicated would probably on some estimates result in a complete cessation of repayment and might conflict with other essential Government expenditure. In any case the test seems to us fallacious in principle. It would only be appropriate (i) if there were a clear-cut fund of national savings available either for trade, etc., purposes or for taxation, and (ii) if sums raised in taxation were wholly diverted from productive purposes. It is perfectly clear that the fund of national savings is not static, but is influenced by whatever taxation may be imposed; it is equally clear that revenue is far from representing a total loss to industry, and, in particular, that the sums applied to debt repayment become in a large measure available for industry. Underlying the whole argument there is an exaggerated view of the dislocatory effects of taxation : we think it quite clear that a considerable volume of savings can be transferred from taxpayers to debt holders without the slightest dislocation to industry.

989. By far the greater number of witnesses before us who have dealt with the question of debt redemption, have taken the line that the present provision from revenue of £50 millions a year is reasonable and adequate. In most cases, however, this view has not been supported by any reasoned argument, and we feel that it is probably due to a tendency to accept things as they are as being preferable to possible alterations in taxation. Specific proposals have, however, been put before us by some witnesses for an increase in the provision for debt redemption.

990. Professor Cannan, who took the view that it would in normal times pay the State to raise more taxes in the present in order to secure having to raise less in a long future, suggested

that the aim should be to repay the debt in a period of about 35 years. He reached this period partly by reference to the practice of the State in fixing the period of loan repayments for Local Authorities; partly by reference to the psychological effects of fixing a date for total redemption " which people up to 50 years of age may reasonably expect to see." He calculated that the charge on the 4 per cent. tables for interest and principal would under his suggestion be £400 millions per annum for a period of 35 years, the capital redemption portion of the charge commencing at £100 millions and increasing each year as the interest charge fell (*E. in C.;* 7-8). While he thought that the addition of £50 millions to the present Sinking Fund should be found by reducing other Government expenditure, he was, on the whole, in favour of raising additional revenue, if necessary. (Q. 926.)

Mr. F. W. Hirst thought that Professor Cannan's proposal was perhaps expecting a little too much of human nature in this and the next generation. He suggested that the surplus released year by year by the reduction of the interest charge should be equally divided, half going to swell the Sinking Fund and half to the relief of the taxpayer (*E. in C.;* 4). In examination, however, he expressed himself as opposed to increasing the Sinking Fund, unless it could be done by a reduction of expenditure. (Q. 2390.)

991. Dr. Dalton regarded the present Sinking Fund as quite inadequate; if it were non-cumulative, it would take nearly 150 years to pay off the debt. He thought that any Sinking Fund should be at least to some extent cumulative, and that it should start from a higher initial figure; the minimum which should be provided at the present time was £100 millions, and this, if fully cumulative, would repay the debt in about 30 years. (*Ev.*, p. 394; *E. in C.;* 10.) In default of a Capital Levy, he supported either this scheme or alternatively a Sinking Fund not quite so strongly cumulative, supplemented by a plan for the compulsory creation of terminable annuities (*cf. para.* 929 *et seq.*).

992. Professor D. H. Macgregor, taking into account the present industrial position, argued that since a large part of the debt could not be converted for five years, it would be reasonable to retain the Sinking Fund at the present figure for that period. If the total charge for interest and repayment were then stabilised, the Sinking Fund would double itself at 4 per cent. in about 18 years, with the result that at the end of 23 years the Sinking Fund would reach £100 millions, and the amount applied to redemption by that time would be about £1,500 millions. He would then maintain the Sinking Fund at £100 millions so as to redeem the remainder of the debt in at most 60 years, plus a few years to allow for final scaling down. If windfalls from the Old Sinking Fund were neglected, or

appropriated in relief of bad times, from 85 to 90 years would be the maximum period involved under his proposal, on the assumption that the efficiency of the Sinking Fund was not diminished by changes in the rate of interest (*E. in C.*; 12).

Lord Bradbury was not disposed to make an immediate increase in the annual provision for redemption except to the extent of the interest saved by redemption and conversion. He favoured a fixed debt charge of the amount of the present provision for the service of the debt for a period of ten years. At the end of that period, the amount might be revised to (say) the then interest charge plus £100 millions, which would operate as a cumulative Sinking Fund (*E. in C.*, 9). He was not in favour of increasing taxation in order to accelerate repayment further than this. At the same time he would maintain the Old Sinking Fund, but in deficitary years he would not object to meeting the deficit by suspension of a part of the fixed provision (in so far as it was not earmarked to contractual Sinking Funds) up to an amount not exceeding, say, the amount of special redemption out of surpluses during the preceding three or five years. This, he thought, might be a useful expedient, in course of time, in obviating the necessity for frequent changes in taxation (*E. in C.*, 11).

993. Other suggestions may be briefly summarised. Professor W. R. Scott suggested that the Sinking Fund should be increased as soon as circumstances permitted up to 1 per cent. of the debt outstanding, and that payments made to this country by foreign debtors should be applied to the redemption of debt (*E. in C.*; 30-31). Mr. P. D. Leake advocated a Sinking Fund of not less than one-half of one per cent. per annum (amounting to £33 millions) which, added to the interest on the debt redeemed, would repay a 5 per cent. debt in 50 years (*Ev.*, *p.* 331; *E. in C.*; 3). Professor Pigou was in favour of the gradual increase of the Sinking Fund to £100 millions by additional taxation if necessary. (Q. 6078.) He had no definite time limit to propose, but considered that debt should be repaid as quickly as it could without severe inconvenience; one would have to see how inconvenient it was, as time went on. (Q. 6083.)

994. We cannot pretend in this brief summary to have brought out the considerations which influenced the individual witnesses in making their proposals. The feature common to most of them is that the Sinking Fund should be increased by the addition of a part or the whole of the interest saving on debt redeemed. The variation in the extent to which the several witnesses would provide for redemption appears, however, to follow almost entirely from their individual views upon the weight of present taxation and upon the desirability of reducing debt: no clear-cut independent principle seems to emerge. Professor Cannan does, indeed, suggest a particular criterion, but we are unable to regard the analogy with the Local Authority as of real guidance; we know of no Local Authority with

a debt per head in any degree approaching that of the National Debt, and for the most part, as Professor Cannan agreed, those debts are reproductive.

995. We are forced to the conclusion that there is no formula by which one may determine the rate at which debt repayment should proceed. The choice is between continuing to bear a heavy interest charge or making a greater present effort in order to secure future relief. For the former course it may be argued that the burden will be relieved by an expansion in productivity; by reductions in the interest charge through conversions to a lower level of interest; and by such repayments of debt as it may be possible to make out of loans due to this country. While some relief is to be looked for in these ways, we have already expressed the view that there is nothing to warrant a belief that productivity will increase at a rate on the scale of the Victorian era (*para.* 682). The reasons which we have already set out are, in our view, conclusively in favour of sustained efforts to reduce the debt.

996. The problem is, in the main, to balance the harmful effects of the necessary taxation against the benefits of a lower debt. Clearly such a balance must depend to a great extent upon the comparative weight which, after an examination of the taxation system, we attach to the two factors, tempered by some consideration of the equity of distributing the burden of repayment amongst individuals of this and succeeding generations. There arises, however, the obvious difficulty that the future volume of taxation for general purposes is unknown; and the effects of either an increase or decrease cannot be surmised in the absence of such knowledge. An increase in debt redemption, if it were possible without increasing taxation, is in a different category from an increase to be wholly financed by further taxation.

997. There are certain practical considerations which are of some account. As we have already indicated, the country, under its contracts with investors in certain loans, is committed to provide specific redemption funds in one form or another. Legally, no doubt, these funds might be provided by new borrowings, but this course is clearly undesirable, and, particularly in the case of those loans in which the declared intention of the fund is to support the market price rather than to provide for ultimate redemption, we think it would come very close to a breach of the undertaking given. The particulars of these commitments are shown in paragraph 189 of our Report; the total requirements in future years are indeterminate, but will form a not unimportant proportion of a Sinking Fund of the present dimensions. Those requirements, whatever they prove to be, indicate therefore the minimum Sinking Fund.

998. We have already noted (*para.* 70) that interest on National Savings Certificates is provided in the Budget only to the extent to which that interest is expected actually to be paid

in the year upon certificates presented for encashment. There is, therefore, a liability, for which no provision is made, in respect of the interest accumulating on certificates outstanding. This liability, which is shown annually in a note in the Finance Accounts, was estimated on the 31st March, 1924, at about £80 millions; on the 31st March, 1925, at about £90 millions, and on the 31st March, 1926, at about £100 millions. While interest is not being met in full, it is fallacious to regard the present Sinking Fund as an effective provision of £50 millions. After full consideration of the evidence tendered by Sir Otto Niemeyer on the matter (Q. 8726 *et seq.*), we agree with him that no alteration in the present practice of budgeting only for actual cash requirements for interest payments is called for, but we think it of importance to point out that, in effect, the present Sinking Fund provision is offset to the extent of the interest not provided. Whether or not the interest will eventually have to be paid as such in full depends to some extent upon the reception of the offers now open to holders of certificates of the first issue to convert into other Government securities; that does not, however, essentially alter the position, since conversion will result in the capitalisation of that interest. The figures of accumulated interest given above—showing an annual increase of £10 millions—suggest that the present Sinking Fund, to accord with the view that £50 millions is reasonable, would require to be raised to £60 millions.

999. Though, as we have said, it is impossible to foresee future rates of taxation, it is permissible to consider the probability of some accession to the revenue (under the present procedure) as the result of repayments to this country in respect of allied war debts. We are strongly in favour of applying all receipts in respect of principal repayments of loans made by this country for war and reconstruction purposes as an additional contribution to the redemption of debt, and we are glad to note that this course is being followed wherever such receipts are definitely identifiable as principal. For the major part of these debts the terms of settlement made (or proposed) will result in a payment to this country less than the interest charge on the debt created in respect of the original loans. Such receipts have, up to the present time, been brought into revenue. So far as they may in the future exceed the present amount, there is clearly latitude for an increase of debt redemption without imposing additional taxation for the purpose. A qualification has, no doubt, to be made that, on the other side, there is likely to be a diminution in the amount of the special war receipts which at present form an appreciable item of revenue, and that the payments of interest on the debt to the United States will increase by about £5 millions in 1933-34.

1000. *Conclusion.*—After careful consideration of the whole of the findings recorded in our Report both in regard to the burden

of taxation and the desirability of reducing the debt, we have reached the conclusion that, as a more or less permanent contribution, the present provision of £50 millions a year out of revenue for debt redemption is insufficient. At the same time, we are not prepared to recommend any immediate drastic increase of taxation; though we think its burden is frequently exaggerated, we consider that any drastic increase would, in present circumstances, be definitely harmful.

1001. We recommend that steps should be taken to increase the Sinking Fund as early as possible to £75 millions a year. We should hope that, with the aid of additional allied loan repayments, reductions in the interest charge from conversions and repayments, and possibly, expanding revenue, this would become possible within a period of, say, five years without the imposition of additional taxation. If, on a survey of budgetary prospects, that result is considered to be impossible of achievement, we recommend that additional taxation should be imposed to the extent necessary to raise the Sinking Fund by steps to that figure within, say, five years. We would only add on this point that we recognise that the industrial disturbance of the present year may make it impracticable to put this programme into force immediately, even if our recommendation is accepted in principle.

1002. With regard to the further outlook, we think that the aim should be to increase the Sinking Fund by degrees to £100 millions per annum. We contemplate that this should be possible, without additional taxation, by applying the major part of the interest saving over a period of, say, from seven to ten years. Whether or not taxation rates can simultaneously be reduced depends upon expenditure in other directions, the possibility of economies in which is being explored by other bodies at the present time. We feel strongly, however, that no reduction should be made which would endanger the carrying out of the above programme. Similarly, we think that any embarkation upon new expenditure of whatever nature should only be made if, at the same time, conditions are held to permit of the increase of the Sinking Fund to the above dimensions.

1003. In addition to the provision of a definite Sinking Fund on the scale outlined above, we contemplate the continuance of the existing arrangements under which identifiable capital receipts in respect of loans due to this country and certain minor receipts by the National Debt Commissioners are applied to debt redemption, together with any surplus of revenue over expenditure in the financial year.

1004. We think our recommendation represents a reasonable and adequate programme of debt redemption, which it should be possible to pursue without entailing an undue burden on the community. To put it higher would, we feel, be in the long

run to invite its non-observance. Whether or not it may be possible in a more remote future to accelerate repayment must be left for another generation to decide.

1005. If the suggestion we have made is accepted, it will be necessary in due course to make further statutory provision for the increase of the Sinking Fund. The precise form which legislation should take may be a matter of some difficulty since the increase we suggest will not necessarily proceed upon a regular scale; we have no doubt, however, that a formula can be devised. We would only add on this question that we have considered various arguments regarding the form of the Sinking Fund, bearing in the main upon the safeguarding of the Fund from raids to meet other expenditure or to reduce taxation. There is little doubt in our minds that hypothecation to particular loans is the greatest safeguard possible, but on other grounds we have decided against any extension of that practice (*para.* 217). The history of the Sinking Fund in the past leads us to the conclusion, however, that there is no possible device which can absolutely ensure the continuance of debt redemption, if the Government of the day decides on a contrary policy. We can only hope that, in the knowledge of the small impression which was made upon debt created for the Napoleonic wars by the weak debt policy during a period of unexampled increase in productivity, the Governments of the future will realise the need for a steady and regular continuance of adequate measures of redemption. Rather than resort to any measure of concealment of Sinking Funds; we would stress the importance of demonstrating as clearly as possible the full strength of the Sinking Fund policy.

1006. The proposals which we have made provide for a continuous policy irrespective of the state of trade. On this point witnesses have, in general, suggested that all the variation necessary can be secured through the application of surplus revenue to the redemption of debt; in the main, it is held that a policy of variation would inevitably lead to little progress being made. It is possible, of course, that the provision of a constant sum might in times of real depression entail a higher rate of taxation than would be necessary in times of real prosperity, and that a slump might in consequence be intensified. The difficulties of fixing any definite or automatic scale of variation are evident, and we share the views of our witnesses that, in the absence of an indisputable test, a variable scale would constantly give scope for providing only the minimum requirements. Some reflection of trade conditions may, perhaps, be looked for in the state of surplus revenue; obviously, however, that depends not so much upon the state of trade as upon the correctness of budgeting which should take account as far as practicable of all factors likely to affect the revenue of the year.

1007. We have now completed our recommendations on the question of debt redemption, and propose only to refer briefly to a few allied points. We have shown in an earlier section of our Report the possibilities of effecting a saving in the interest charge through conversion operations upon what may, perhaps, be termed the most favourable assumptions (*para.* 191 *et seq.*). Clearly it is of consequence to foster the most favourable financial conditions for the large operations which remain to be undertaken, and to that end we think our recommendations for a larger measure of debt reduction should assist.

1008. With regard to the form of securities to be offered in future, we have made only three recommendations—that loans should not be issued at a price very substantially below par (*para.* 170) ; that specific Sinking Funds should not be attached to future issues (*para.* 217); and that, as far as possible, special tax privileges should not be attached to loans (*para.* 179). Apart from these points, the choice of the type of security to be issued must, we think, be determined, in consultation so far as may be with competent authorities, by reference to the conditions obtaining at the time of issue. How far it may prove possible to avoid the issue of short-term securities it is impossible to foresee. In general, so far as conditions permit, it seems to us sound policy to proceed in the main with issues of securities in funded form, with an option to the Government to repay at a not too distant date. At the same time, given a definite policy of debt reduction we think there may be advantage in combining with funded issues a proportion of long-term issues definitely redeemable within a period of, say, 40 years, and with an option to the State to redeem at an earlier date. Funded debt is obviously most in favour when interest rates are expected to fall and redeemable loans when they are expected to rise or when feeling is very indefinite. It is observable throughout the evidence given before us that views as to future interest rates are by no means uniform, and there is therefore some ground for thinking that the widest appeal would be made by a judicious mixture of both types of loans.

1009. The only concrete suggestion made to us for a new form of security was by Mr. Keynes, who proposed the issue by the Government of bonds, the capital and interest of which would be paid not in a fixed amount of sterling, but in such an amount of sterling as has a fixed commodity value as indicated by an index number compiled for the purpose. (*Ev.*, *p.* 278 ; *E. in C.*, 5.) He considered that the State could float a certain volume of bonds economically by catering for people who wished to be free from risks arising out of variations in the value of money ; in particular he mentioned colleges and other long-lived institutions, and bodies engaged in building up pension funds. While especially directing attention to the wide loss in values during the War, Mr. Keynes also indicated that over a very long period the value of any legal tender had always tended to fall towards zero. (Q. 4015.)

1010. While we do not doubt that Mr. Keynes' proposal would be welcomed by a certain class of investor, we are inclined to the view that that class would be so limited that the creation of yet another variety of Government loan would not justify itself. Mr. Keynes put it that, unless the Treasury hoped to make a profit through the depreciation of legal tender, it would lose nothing and might gain something in terms of interest by issuing these bonds. We would prefer to say that, if there is depreciation of legal tender, all holders of fixed interest securities will suffer; any particular class granted immunity from the fall gain at the expense of the rest of the community. The issue of loans of this nature thus appears to demand an adequate consideration in the price of issue for the insurance given; any real basis for judging the financial advantage to the community as a whole is, however, lacking.

1011. It is to be anticipated, so far as the deadweight debt is concerned, that future debt operations will be in the nature only of conversion and reborrowing transactions, which, in their effects on the national credit, are in a category distinct from entirely fresh borrowings. We would in this connection stress the desirability of confining to the narrowest possible limits the issue of securities to which the Government's guarantee is attached. Whatever may be their merits in other directions, we feel that the expansion of the area of what are, in effect, Government loans is definitely adverse to the success of the conversion operations yet to be undertaken.

II.—TAXATION UNDER THE SINKING FUND POLICY.

1012. With reference to taxation in pursuance of the Sinking Fund policy we have little further to say. We had no mandate to pursue a general enquiry into possible new sources of revenue for meeting the ordinary annual requirements of the Exchequer; nor had we a mandate to examine the detailed provisions of the existing tax law with a view to recommending small adjustments. Our analysis in Part I of this Report does not suggest that existing taxes are so defective as to necessitate the search for entirely new forms of taxation in order to supersede them. Again, if it should unfortunately be found necessary to raise more revenue than could be obtained from the taxes at the rates now existing, it does not appear that the system would be incapable of further expansion, since there is considerable elasticity in the most productive source of revenue, the Income Tax and Super-tax.

1013. In the course of our examination of existing taxes, we have passed certain comments which may suggest possible lines of improvement, subject to difficulties or objections which we point out, and also to the many Budget considerations which lie outside our province. We have also referred to a few proposals for tax amendment, which have come

before us. In general, however, as stated at the beginning of our Report (*para.* 5) we have regarded technical matters of assessment as outside our province. Thus we have not discussed the comparative merits of the various bases of assessment to Income Tax, or the adequacy of the Income Tax provisions relating to depreciation, &c.—matters which were closely examined by the Royal Commission on the Income Tax, and on which relatively little evidence has been placed before us; we have noted that the Finance Act, 1926, abolishes the three years' average basis of assessment as from 1927-28. Turning to a matter affecting a particular class of business, we may observe that a proposal for relieving the broker and general commission agent from liability to Income Tax in respect of the profits of a non-resident principal, which was urged before us by Sir Keith Price—one of the witnesses appearing on behalf of the London Chamber of Commerce on the 5th May, 1925—was also raised in Parliament, and was dealt with in the Finance Act, 1925.

It may be useful to review briefly certain of the more specific points to which we have given attention.

Income Tax.

1014. *Family and earned income reliefs.*—We have noticed that a great difference is made in the lowest range of incomes (taken, for convenience, up to £500) by the family allowances and by the earned income relief (*para.* 339). As regards family allowances, however, a point is soon reached beyond which the increments of tax per £100 of income are exactly the same for the married person as for the single, and some of us think that, if regard is had solely to ability to pay, the amount of the family allowances ought to vary to some extent with the size of the taxpayer's income, instead of being absolutely fixed (*paras.* 358 *and* 362). Again, as regards earned income, the relief (while varying in proportion to the taxpayer's income, subject to a fixed maximum) is inadequate to measure the difference in ability to pay between " pure earned income " and " pure investment income," although an important corrective is introduced by the death duties; we point out, however, the great difficulty of reducing this defect (*paras.* 356-7 *and* 362).

1015. We have checked these criticisms by reference to other important considerations from the point of view not of the individual but of the community. In the middle range of incomes, taxation often furnishes a particularly strong incentive to extra effort and economy on the part of the married man and the earner (*paras.* 359 and 367). On the whole, therefore, work and saving are likely to benefit from a scheme of graduation under which the married taxpayer and the taxpayer dependent on earned income are asked to contribute something more than in proportion to their relative ability to pay, as compared with the single taxpayer and the taxpayer

with investment income; how far taxation policy should be influenced by this consideration is another matter. Again, a scheme under which investment income was much more heavily taxed than earned income would be likely to exercise a more deterrent influence on saving—and also on the more enterprising use of savings—than the existing scheme, particularly in the case of individuals with incomes liable to Super-tax; for this reason we have expressed a preference for an increase in the standard rate of tax, rather than an increase confined to investment income, if in any circumstances a very substantial additional yield were required (*cf. paras.* 382, 449 and 905.)

1016. *Industrial reserves.*—It has often been urged that relief should be given in respect of the sums put to reserve out of profit by companies. This far-reaching proposal was advocated by a number of our witnesses, although others did not support it. Apart from the theoretical merits or demerits of a differentiation in favour of company savings, the question of its practicability, or of the form in which it might be practicable, is a much more serious one than is usually recognised. Of the witneses who appeared on behalf of the Accountant Societies, Sir Arthur Lowes Dickinson, representing the Institute of Chartered Accountants, and Sir John Mann, representing the Councils of the Chartered Accountants of Scotland, expressed personal opinions in favour of some measure of relief in respect of sums put to reserve for development purposes, while Mr. George Stanhope Pitt, representing the Society of Incorporated Accountants and Auditors, was understood not to dissent (Qs. 3492-3515). Moreover, it appeared that the societies had considered advocating such relief in their corporate evidence (Q. 3492). Certain practical difficulties were discussed, and we subsequently issued a detailed questionnaire directed to these difficulties, in the hope that the Accountant Societies would be prepared to express a corporate opinion on the several points. The Councils of the Societies, however, did not feel in a position to submit representative answers, or to indicate the preponderance of view in the accountancy profession, and we were left to understand that any individual advocacy of relief was to be taken as purely personal, and not as representing the profession as a whole. Sir John Mann afterwards wrote that, as he had indicated in evidence, the proposal at first sight seemed attractive, but was obviously open to " very practical difficulties " ; the more he had considered the details the more he was satisfied that those practical difficulties were insuperable, and therefore he could not support the proposal. Sir Arthur Lowes Dickinson, however, still thought that in a certain form the relief of reserves for development could be carried out, and sent in a statement in answer to the questionnaire. The questionnaire and the statement are printed in Appendix XXVIII. For particulars of Sir Arthur's suggestion we refer to the Appendix, but we may say briefly that he proposes the creation of a Special Development Account over and

above general reserves, &c., this account being represented by additional buildings, plant and machinery, by additional working capital or by additional investments in securities. It would be necessary to admit investments in the account, since obviously it would not always be possible for the business to apply moneys immediately to development purposes; but it appears to us that this element would give rise to great difficulty, as indeed was suggested by Sir Richard Hopkins. Sir Richard thought that the question of motive must inevitably arise under any scheme attempting to discriminate in favour of a particular class of reserves, and that, if any relief were given, it would have to be on rough-and-ready lines (Q. 9125). We are inclined to agree with this view; such relief would extend to accumulations made against losses, in regard to which there would be no theoretical ground for relief.

1017. As regards the principle of the proposal, we have seen that under the existing system the limited company already has a considerable advantage, as compared with the large private firm, in that its reserves are not liable to Super-tax (*para.* 399); if, in addition, some relief were given from the standard rate of Income Tax, it would be very difficult to withhold it from the reserves of private firms, which would have a claim not only on the plea of equity, but also on the ground that their savings, like those of the public company, had special value for the community (*para.* 419). If, however, relief were conceded, the practical difficulties of applying even a rough-and-ready scheme would be very greatly increased.

1018. The question of equity goes further. It would certainly be asked why relief should be given to business savings alone, and withheld from the savings of professional men and others. Purely from the standpoint of equity it would be difficult to find a convincing answer, although it would be easy to show that, the wider the relief were extended, the more expensive and the more unworkable would the scheme become.

1019. Finally, if company reserves were granted some relief, the relief would mainly benefit the industries which were already in a position to put large amounts to reserve; it would be of comparatively little avail to the companies which were making low profits. This point is of obvious importance in the present situation. We have seen that while the aggregate sums being put to reserve by companies may be viewed with some satisfaction, there is great disparity between different industries, a notable decline having taken place in the heavy industries subject to foreign competition (*para.* 51). It is these latter which are in most need of assistance, and which would derive least under the proposal. In fact, the proposal would accentuate the difference in fortune between them and the sheltered industries.

Altogether, when questions of practicability and of principle are considered, we are forced to the conclusion that the proposal is radically unsound, despite its superficial attractiveness.

1020. An alternative method of relieving industrial reserves was suggested by Mr. Keynes, who also discussed the question in relation to the funds of insurance companies. The essence of his proposal was that the standard rate of tax should be reduced and the graduation revised, the Super-tax limit being brought down, and the effective rates on the individual being increased, so far as necessary, in order to maintain the total yield of the tax. This proposal would avoid many of the practical difficulties associated with the scheme we have just considered, but in principle it would be open to some of the same criticisms. Moreover, to bring down the Super-tax (or "personal tax") limit much below £2,000 would greatly multiply the number of individuals—and increase the amount of income—to be dealt with by direct personal assessment instead of by taxation at the source. As a result there would be inevitable loss through evasion; this was recognised by Mr. Keynes, who regarded it as the main objection to his proposal. (Q. 3895.) We cannot recommend that the proposal should be adopted.

Death Duties.

1021. *Life insurance policies.*—We are opposed to the suggestion that differential relief should be given in favour of life insurance policies, mainly for the reason that those policies only represent one particular kind of savings (*paras.* 496-7).

1022. *Avoidance.*—We have endorsed the opinion of several witnesses that the opportunities which exist for avoidance are a marked defect of the Estate Duty (*para.* 498). The deliberate legal avoidance of duty takes many forms and we do not think that it could be satisfactorily checked by any simple measure. The most obvious form of avoidance is through gifts *inter vivos*,* which escape duty under the present law, unless they have been made by the testator within three years of his death. To increase the three-year period would be of doubtful assistance, as it would increase the difficulty already experienced by executors in tracing dutiable gifts. Moreover, it might tend to the wider adoption of methods which do not depend for their success on the duration of the testator's life. As regards these other forms of avoidance, again—e.g., the various ways in which the formation of companies may be turned to account—we do not think it likely that any slight or simple remedy would be of much avail. It appears to us that avoidance is a matter

* Obviously such gifts may be made from quite other motives than that of avoiding duty, and we do not question that in some cases the partial distribution of an estate before death may be economically desirable. Moreover, even deliberate avoidance by gift is much less objectionable than avoidance through the forming of a company, which leaves the testator in virtual control and enjoyment of the property.

which may require to be dealt with by legislation, and that drastic provisions may have to be faced, if they are found to provide an effective way—and the only effective way—of checking the trouble.

1023. We may add that, without stronger safeguards than exist at present, we are inclined to think the Estate Duty on the largest estates so heavy as to endanger the full yield. This suggests that, if it were thought desirable to aim at a more even progression than that now existing (*cf. graph in Appendix* XVI), it would be wiser to moderate the scale for the highest ranges of estate rather than to stiffen it for properties of less magnitude.

1024. *The inheritance tax principle.*—We have referred to the contention that the death duties should be graduated by reference not to the whole estate passing (as in the Estate Duty), but to the inherited share (*paras.* 490-4); we have also noticed the suggestion that the graduation might take account of the other wealth of the beneficiary (*para.* 539). Although we have concluded that, on balance, the equity of the Estate Duty can well be vindicated (*para.* 495), we have said that we think the argument for the inheritance tax principle not entirely without force (*para.* 494).

1025. We should be very definitely opposed to the substitution of a single inheritance tax for the present system. The Estate Duty has many merits, it is well established, and it plays an important part in the adjustment of direct taxation to ability to pay (*para.* 475 *et seq*). Moreover, as the Board of Inland Revenue state in a Note on the Practical Aspects of an Inheritance Tax (*Appendix* XXVII), the Estate Duty is collected very cheaply, and much more so than an inheritance tax could be. At the same time the incidence of the Estate Duty is not uniformly on the testator (*para.* 454), and it is clear that any form of death duties taxation must affect the beneficiary. Our review of the Estate Duty and the Legacy and Succession Duties suggests that it may be desirable to develop the latter two—which represent at least some recognition of the inheritance tax principle—beyond their present rather rudimentary stage (*para.* 540), perhaps refining on the distinctions of relationship which now form the sole test (*para.* 537), as well as introducing new elements into the basis of graduation. On broad grounds of equity we think there is much to be said for the inheritance tax principle occupying a more considerable position that it now does in the death duties system.

1026. At the same time we have no doubt that any graduation by reference to the inherited share or to the total wealth of the inheritor, would produce its own greater or less anomalies. We may take, as only one example, the case of a man with £100,000, whose son is building up a fortune of his own, and

consider what may happen under a scheme taking the total wealth of the inheritor into account. If the son comes into the £100,000 at the age of 35, his "other wealth" may be, say, £20,000. If he comes into it at the age of 55, his "other wealth" may be £80,000. In the former case he may, according to the life tables, expect to enjoy the £100,000 for 32 years, in the latter case for 17 years. It is not clear that he ought to pay more duty in the latter case. Indeed, the test of "other wealth," in this not very extreme example, would seem to act in a distinctly arbitrary way.

1027. We recognise that the recommendation of any wide departure from the present system could only be justified after a very full consideration of the many questions involved, including difficulties of administration such as are adumbrated in the Board of Inland Revenue's Note (*Appendix* XXVII) : for such an investigation we are not qualified by our terms of reference.

Stamp Duties.

1028. Generally we have not viewed the Stamp Duties with much favour. Here we need only repeat that, if the £2 per cent. duty on bearer bonds should be detected as having any material influence on foreign loan business, the rate of duty should be lowered (*para.* 565).

Customs and Excise Duties.

1029. *The food duties.*—We have expressed the view that the food duties, even as reduced by the Finance Act, 1924, must still exercise some adverse effect on the standard of living of the poor (*para.* 660). We consider that the sugar duty is relatively high and that, if any relief in taxation is found possible in the next few years, it should be applied first in reduction of this duty.

1030. *The area of indirect taxation.*—We have expressed the opinion that, while existing Customs and Excise duties have no very disturbing effect, the general tendency of indirect taxation is to cause dislocation and to interfere with natural channels of trade (*paras.* 590-1). We think there is a presumption against widening the area of commodities subject to tax.

1031. *The turnover tax proposal.*—We think that, *prima facie*, there are extremely strong objections to a tax on turnover, either in the cumulative form—i.e., imposed at each stage of manufacture and production—or in the form of a tax levied on one sale only, whether at the point of final consumption or earlier. In the latter form the tax was suggested by Mr. Selfridge as a substitute for part of the existing income taxation, making it possible to raise "a lot of money which no one would feel" (*E. in C.*, 8, and Q. 7261-3). In our view, the Income Tax, which can be graduated according to ability to pay and which is not passed on in prices like an indirect tax, is a

far superior instrument of taxation from the standpoint both of the individual and of industry. In theory and intention the turnover tax is one to be passed on to the consumer. It would undoubtedly lead to rising prices and, as a consequence, to wage disturbances. In the case of a cumulative tax the price of food could not remain unaffected, whatever specific exemptions might be provided. From the point of view of industry the tax would be generally harmful as leading to increased costs, and would enhance the difficulties of industries open to foreign competition : it would seem imperative to allow drawbacks on export and to impose countervailing import duties. We are aware that turnover taxes exist in various foreign countries. In this country, however, economic and other conditions appear to be very unfavourable to it. Moreover, in this country the taxpayer is willing to bear a large annual burden of direct taxes, which, as we have said, constitute in our view a much higher order of taxation. Yet again, we would point to the large burden already imposed by existing indirect taxes on small incomes. In our view the considerations we have briefly referred to are sufficient in themselves to indicate that the adoption of a turnover tax in place of any part of the direct taxes would be a retrograde step.

We desire to place on record our deep sense of obligation to Mr. G. R. Hamilton and Mr. G. Ismay for their services as Secretaries to the Committee. Their work has been protracted and laborious, demanding high intellectual qualities. It has been performed throughout with unfailing regularity and efficiency and a mastery of the subjects involved. We are particularly indebted to them for the great assistance they have given in the preparation of this Report.

We have the honour to be,

My Lords,

Your obedient Servants,

COLWYN (*Chairman*).
C. S. ADDIS.
A. G. ANDERSON.
A. BALFOUR.
HENRY BELL.
W. L. HICHENS.
WILLIAM McLINTOCK.
J. C. STAMP.

G. R. HAMILTON (*Secretary*).
G. ISMAY (*Assistant Secretary*).
15*th November*, 1926.

Alphabetical List of Witnesses.

(In the references to Minutes of Evidence only evidence confined to the Capital Levy has been included in the second column ; the general evidence in some cases includes references to a levy.)

Name of Witness.	Bodies represented.	Minutes of Evidence.	
		General evidence, Page	Capital Levy, Page
Alexander, Mr. A. V., M.P.	Joint Parliamentary Committee of the Co-operative Congress (joint evidence).	303	564
Bailey, Mr. Milne	Trades Union Congress, General Council (joint evidence).	228, 359	—
Barrett, Mr. Horace ...	London Chamber of Commerce (joint evidence).	528	—
Bell, Sir Hugh, Bart., C.B.	—	595	—
Blair, Mr. W. R.	Joint Parliamentary Committee of the Co-operative Congress (joint evidence).	303	—
Blakemore, Mr. Felix J., F.G.I.	National Chamber of Trade (joint evidence).	189	—
Ditto.	—	201	—
Bowley, Professor A. L., Sc.D.	—	265	—
Bradbury, Rt. Hon. Lord, G.C.B.	—	662	—
Brand, Hon. Robert Henry, C.M.G.	—	105	—
Cannan, Professor Edwin, LL.D.	—	58	—
Carlton, Mr. H. W., F.S.I., F.L.A.S.	Land Agents' Society (joint evidence with Central Landowners' Association).	24	—
Carslake, Mr. L. B. ...	Council of the Law Society (joint evidence).	540	—
Clark, Mr. J. Walker, J.P.	National Chamber of Trade (joint evidence).	189	—
Clinton, Rt. Hon. Lord ...	Central Landowners' Association (joint evidence with Land Agents' Society).	24	—
Coates, Mr. W. H., LL.B., B.Sc.	—	636, 672	—
Dalton, Dr. Hugh, M.P. ...	—	393	492
Dickinson, Sir Arthur Lowes	Institute of Chartered Accountants in England and Wales (joint evidence with other Accountant bodies).	243	—
Duncan, Mr. Joseph F. ...	Scottish Trades Union Congress General Council (joint evidence).	203	—

Name of Witness.	Bodies represented.	Minutes of Evidence. General evidence, Page	Minutes of Evidence. Capital Levy, Page
Enfield, Miss A. Honora ...	Women's Co-operative Guild (joint evidence).	471	—
Forres, Rt. Hon. Lord ...	—	552	—
Glenday, Mr. R. G. ...	Federation of British Industries.	347	—
Goodwin, Mr. T.	Joint Parliamentary Committee of the Co-operative Congress (joint evidence).	303	—
Hayward, Alderman F. ...	Ditto.	303	564
Hirst, Mr. F. W.	—	163	—
Hoare, Mr. Alfred ...	—	115	—
Hobson, Mr. J. A. ...	—	118	—
Holme, Mr. Randle ...	Council of the Law Society (joint evidence).	540	—
Hopkins, Sir Richard, K.C.B.	Board of Inland Revenue ...	656	—
Hunsdon, Rt. Hon. Lord...	—	148	—
Kean, Mr. W.	Trades Union Congress General Council (joint evidence).	228, 359	587
Keynes, Mr. J. M., C.B. ...	—	277	534
Kirkaldy, Professor A. W.	—	214	—
Layton, Mr. W. T., C.B.E.	—	172	—
Leake, Mr. P. D.	—	331	463
Macgregor, Professor D.H., M.C.	—	423	—
McKenna, Rt. Hon. Reginald	—	131	479
Mann, Sir John	Joint Committee of Councils of the Chartered Accountants of Scotland (joint evidence with other Accountant bodies).	243	—
Martin, Sir James, F.S.A.A.	Association of British Chambers of Commerce.	288	576
Matthews, Mrs.	Women's Co-operative Guild (joint evidence).	471	—
Niemeyer, Sir O. E., K.C.B.	H.M. Treasury	3, 619	—
Paine, Mr. William Wor-hip	—	—	369
Pease, Mr. J. Beaumont ...	—	317	—
Pethick-Lawrence, Mr. F. W., M.P.	—	—	448

Name of Witness.	Bodies represented.	Minutes of Evidence.	
		General evidence, Page	Capital Levy, Page
Pigou, Professor A. C. ...	—	39	436
Pitt, Mr. George Stanhope	Society of Incorporated Accountants and Auditors (joint evidence with other Accountant bodies).	243	—
Pretyman, Rt. Hon. E. G.	Land Union (joint evidence)	410	—
Price, Sir Keith	London Chamber of Commerce (joint evidence).	521	—
Pugh, Mr. A.	Trades Union Congress General Council (joint evidence).	228 359	587
Rigby, Lt.-Col. W., D.S.O.	—	—	530
Samuel, Mr. Arthur Michael, M.P.	—	73	—
Schuster, Sir Felix, Bart....	—	8	558
Scott, Professor William Robert	—	—	606
Selfridge, Mr. H. Gordon...	—	504	—
Strachey, Mr. J. St. Loe ...	—	546	—
Tredwen, Mr. E. B. ...	London Chamber of Commerce (joint evidence).	516	—
Turner, Mr. John	Trades Union Congress General Council (joint evidence).	359	587
Walkden, Mr. A. G. ...	Ditto.	228 359	587
Walker, Bailie James ...	Scottish Trades Union Congress General Council (joint evidence).	203	—
Watson, Mr. Ernest, F.S.I.	Land Union (joint evidence).	413	—
Wise, Sir Fredric, M.P. ...	—	155	—
Worley, Mr. J. J.	Joint Parliamentary Committee of the Co-operative Congress (joint evidence).	—	564
Wright, Mr. R. S., M.I E.E.	National Union of Manufacturers.	92	—

COMMITTEE ON NATIONAL DEBT AND TAXATION.

MINORITY REPORT.

TO THE LORDS COMMISSIONERS OF HIS MAJESTY'S TREASURY.

MY LORDS,

1. While it will be observed that, on certain matters considered by the Committee, we are in agreement with the majority of our colleagues, we regret that, owing to fundamental differences in the emphasis which we lay on certain aspects of the National Debt and of existing taxation, we are unable to sign the Report presented by them.

PART I.

THE DEBT AND ITS EFFECTS.

Composition of the Debt.

2. Nearly the whole of the National Debt, which on 31st March, 1926, amounted to a nominal total of £7,615,916,000, is the result of expenditure during the War of 1914-18, the pre-war debt (on 31st March, 1914) amounting only to £650,000,000.

3. In the Annexe to this part of our Report, we give a table showing the approximate totals, as at 31st March, 1926, of the various items of which this debt is composed, and the respective dates at which these fall due for repayment.

It may be useful at the outset to give a few words of comment and explanation regarding the composition of the debt as shown by this table.

4. The external debt, as will be seen from the table, comprises about one-seventh of the total. Of a total external debt of £1,110,778,000, nearly nine-tenths is accounted for by our debt to the United States Government. (The item of £135,700,000, "loans from certain Allied Governments," consists of loans from France, Italy and Russia, which are, of course, much more than counterbalanced by the debts due from those countries.)

5. The internal debt falls roughly into three groups, the Floating Debt proper, the medium-dated debt and the long-term and funded debt. The Floating Debt, the amount of which varies from week to week, consists of Treasury Bills (running only for a few months) and Ways and Means Advances, and stood at £704,296,000 at 31st March last, the date of the table. Figures of the Floating Debt are, however, liable to misinterpretation, since a considerable part of this debt is held by Government Departments and Government Funds, i.e., it is owed by the Government to itself. It is impossible to say with

accuracy how much of the Floating Debt is thus held; but it has been suggested to us by Sir Otto Niemeyer that the total might be as much as £150,000,000.

6. The medium-dated debt, i.e., that maturing in the next 25 years, comprises much the greater part of the internal debt, and includes the 5 per cent. War Loan of £2,044,053,000, which is the largest single item in the debt. It will be seen that issues of considerable amount, though widely varying from year to year, fall due for repayment in each of the next five years, amounting in the aggregate to £1,059,054,000 (exclusive of Floating Debt, premiums on National War Bonds, and external debt).

7. The dates of maturity quoted in the table are those at which debt *must* be redeemed or converted. Many of the issues, however, carry options giving the Government the right to redeem (and in some cases options giving the investor the right to claim repayment) at a much earlier date than that of final maturity. Thus the 5 per cent. War Loan may be redeemed at any time from 1929. The total amount of debt which may, or must, be repaid in the next five years amounts to over £3,000,000,000, or nearly half the internal debt.

8. The long-term debt consists of the funded debt proper—Consols, &c., and the 3½ per cent. Conversion Loan, of which £760,015,000 was outstanding on the 31st March, 1926—and of the two long-term issues of 4 per cent. Funding Loan (£391,910,000) maturing in 1990, and repayable at the Government's option from 1960, and of 4 per cent. Victory Bonds. (£347,609,000) redeemable by annual drawings calculated to repay the loan by 1976.

The Interest Charge.

9. The following table shows the cost of interest (excluding management, &c.) on the National Debt for each year since the end of the War. For the purpose of comparison we have added figures showing the total national revenue for each year, and the proportion of this absorbed by payment of the debt interest.

Year.	Cost of Interest on National Debt.	Total National Revenue.	National Debt Interest as percentage of total National Revenue.
	£	£	%
1918–19	265,156,773	889,020,825	29·8
1919–20	322,525,039	1,339,571,380	24·1
1920–21	326,074,004	1,425,984,666	22·9
1921–22	302,157,939	1,124,879,873	26·9
1922–23	297,255,956	914,012,452	32·5
1923–24	305,769,196	837,169,284	36·5
1924–25	309,216,112	799,435,595	38·7
1925–26	306,994,847	812,061,658	37·8

10. It will be seen that the popular estimate that the payment of interest on the debt costs a million pounds for every working day in the year is substantially accurate.

The Burden of the Debt.

11. We have heard a great variety of opinions as to the exact nature of the burden, if any, which this debt imposes upon the country. On the one hand, witnesses have argued that the nation has now become accustomed to a debt on the existing scale, and that this does not now do anybody serious harm. One witness even went so far as to say that " the National Debt and the Floating Debt, if held within the Unted Kingdom, are useful instruments of credit, and increase the previously existing supply of capital for trade and industry." (*Samuel; E. in C., Ans.* 1). On the other hand, it has been represented to us that " the presence of the debt . . . . . is causing the working classes to be deprived of the social amenities and educational necessities of civilised life." (*English Trades Union Congress, Ev. p.* 230, *E. in C.*, VIII (2)). *We are of opinion that, although the injury may not be everywhere recognised, the existence of a National Debt on the present scale does impose a very serious burden upon the nation,* the nature of which we analyse below.

12. In the first place, the debt is almost entirely the result of unproductive expenditure. Of the £7,615,916,000 outstanding on 31st March, 1926, all except £650,000,000 has been accumulated in the past 11 years as a result of the recent War, while the greater part of the remainder has also arisen as the result of expenditure on earlier wars. Whatever the value of the results which this vast expenditure from loans may have achieved (a matter which it is outside our province to discuss), the expenditure itself is evidently unproductive, in the sense that it has provided no revenue-producing asset from which the service of the debt may be met.

The External Debt.

13. The special burden imposed by the *external debt* is of a character which is easily seen, and, we think, generally recognised. The external debt obliges the taxpayers of this country to make payments to the Governments of our creditor countries, giving the latter a claim upon the world's production which would otherwise have been exercised by and for some British citizen or institution. It reduces the real national income of this country.

14. Further, the external debt is calculated in terms of a foreign currency. The debt to America entails an obligation to make payments having a certain gold value. The burden of this debt is, therefore, heavier, the greater the effort that

we have to make in order to obtain the necessary gold or its equivalent. The burden will be increased by every appreciation in the value of gold in relation to commodities generally, or by every diminution in the productiveness of British labour; it will be diminished by converse changes.

15. The world value of gold to-day, owing to the very large stocks of gold which have accumulated in America, depends largely upon the currency policy of the United States, and mainly upon conditions outside the control of this country alone. *The burden, therefore, of the external debt depends upon conditions which we can neither foresee nor control.*

16. Further, under the arrangements made for funding the United States debt, repayment will not be completed until 1985. The period, therefore, during which we are exposed to variations in the burden of the debt over which we have no control, is very long.

The Internal Debt.

17. The *internal* differs fundamentally from the external debt, in that it involves no direct reduction in the aggregate real income available for the citizens of this country. The service of the debt necessitates levying certain taxation and correspondingly reduces the taxpayers' incomes. But the proceeds of this taxation are all paid out again as interest to the debt holders. The debt thus involves a transfer, but no destruction, of purchasing power.

18. It does not follow that no burden is entailed. On the contrary, both internal and external debt appear to us to be serious obstacles in the way of social progress. The very heavy annual charge on the Exchequer entailed by the debt leaves but a small residue for other purposes. Expenditure, therefore, upon new enterprises such as assistance to housing schemes, and on the development of existing services, such as education, is inevitably restricted. We think that this point is well illustrated by the table given above showing the interest charge as a percentage of the total national revenue for each year. It will be seen that from 1920-21 to 1924-25 this percentage increased from 22·9 per cent. to 38·7 per cent., although the actual interest charge fell from £326,074,004 to £309,216,112. *The percentage still stands at 37·8 per cent., so that substantially over a third of all the revenue raised is required for payment of interest on the debt.*

19. The explanation of the rising percentage is simply that during these years the amounts raised in taxation have been very severely limited. Since it is impossible to " economise " on the debt charge (except to the very small extent of the savings in interest consequent upon repayments through the Sinking Funds and conversions) without breach of contract, the

" economy " necessitated by a diminishing income is concentrated on a small part of the total national expenditure, and is correspondingly more severe within that restricted area.

20. We have had to consider the contention that the limit of what we can afford to spend upon the social services is set by the size of the total national income, and that, since the internal debt does not directly either increase or diminish the real national income, we should be no better able to spend on these services were the whole of this debt reduced or even abolished. We do not think that this contention is justified. *The immediate obstacle to increased social expenditure is the difficulty of raising the necessary taxes.* But the less that must be raised in taxation for *one* purpose, the easier it is to find the money for *other* forms of expenditure. To argue that the sums that can be spent on the social services are determined by the size of the aggregate national income, without regard to the proportion of that income taken in taxation, is to assume that expenditure on these services differs from other forms of public expenditure in that it actually destroys a part of the national income.

21. Such an assumption is obviously false. Both expenditure on the internal debt-charge and expenditure on the social services transfer part of the national income, and do not directly destroy any real income whatever. All such transfers necessitate levying certain taxes—a process which is always unpopular, and which, regardless of the purpose for which the funds raised are to be used, is accompanied by certain economic difficulties. Consequently, every reduction in the amount that must be raised for one purpose lessens the difficulty in the way of obtaining funds for other purposes.

22. In concrete terms we are now estimating for a tax revenue of £691,150,000, of which £304 millions are required for interest on the debt. On the supposition that there is any limit to our taxable capacity, it must be true that, if taxpayers had not to pay so much for the cost of the National Debt, they could more easily be taxed for other purposes.

23. Further, we are of opinion that the transference of purchasing power which the service of the debt effects is itself of an injurious character. In estimating the extent of this injury we are much hampered by the lack (which we recognise to be unavoidable) of any definite information as to the distribution of holdings of the debt. The number of registered debt holders runs into very large figures, but, even if it were possible to ascertain the number and amount of individual holdings in the debt, we should still be without any knowledge as to the aggregate wealth of such individuals. Very wealthy persons may have only small holdings in the debt; while persons of only moderate means may have the whole or nearly the whole of these invested in the debt.

24. Moreover, a considerable part of the debt is held by banks and insurance and other companies, and the interest paid on this goes to the profit of the shareholders of these companies. In order, therefore, accurately to estimate the effect of the debt upon the distribution of wealth, we should need to know the position in the scale of wealth and poverty of all the shareholders of these companies as well as of all individual holders of the debt itself.

25. We are thus in the somewhat unsatisfactory position of having to form our conclusions on this matter—which is of primary importance in any discussion of the debt and its effects—on the basis of rough estimates and on grounds of general probability.

26. The following estimate of the general distribution of holdings in the internal debt in 1924 was submitted in evidence by Mr. W. T. Layton.

		£ millions.
Bank of England and other banks	(market value)	820
Savings banks or invested for subscribers through savings banks	,, ,,	455
Treasury Note Reserve and advances by Government Departments	,, ,,	310
Other holdings of Treasury Bills	,, ,,	300
Insurance and railway companies	,, ,,	430
		2,315
Approximate addition to bring preceding items up to par value		277
		2,592
Private persons liable to Estate Duty		2,350
Foreigners, Trusts, Charities, Trade Unions, Joint Stock Companies, etc.		1,650
		6,592

Debt in the hands of Individuals.

27. If this estimate is correct, rather more than one-third of the debt is in the hands of individuals.

28. It appears to us that the transfer of purchasing power from the taxpayer to the individual debt holder is injurious in two principal respects. In the first place, it is reasonable to suppose that these debt holders represent mainly the wealthier classes of the community, and that the transfer accordingly aggravates the already great inequality in the distribution of ownership of wealth throughout the community. This presumption is confirmed by the evidence afforded by the death duty statistics. Of the total property liable to Estate Duty

left at death in 1923-4 in the form of British Government securities issued since 1914, approximately four-fifths was the property of persons having estates worth more than £5,000.

29. Persons worth more than £5,000 constitute, however, the small wealthy minority of the population, estimated at about half a million individuals. *Any charge upon the general tax revenues of which four-fifths or even three-fifths goes to so small a minority is an evident aggravation of the inequality in the distribution of accumulated wealth.* For the graduation of existing taxation is not nearly as steep as the graduation of property ownership. It should not be forgotten that the Customs and Excise duties, of which far the greater part is paid by the relatively poor sections of the community, still account for over one-third of our total tax revenues.

30. We hardly think that it is necessary to argue in detail that anything which makes the distribution of wealth more unequal is both economically and socially bad, alike in itself and in its effect upon the whole trend of our national production. It is, we think, a belief that the effect of the debt as a whole is to aggravate the existing inequality in the distribution of wealth which has done more than anything else to create popular feeling in favour of drastic methods of debt reduction.

31. In the second place, the service of that part of the debt which is in the hands of individuals seems to us to involve a transfer from the active to the passive elements in the community. At the time that the various War Loans were first issued all kinds of motives inspired subscription to them. With the lapse of time, however, the stocks have been bought and sold and have presumably found their way into the hands of that section of the community to whom a first-class gilt-edged security is particularly attractive. Such securities must figure largely in the property of persons who are not engaged in active production and enterprise, including those who have retired from business. It has been suggested to us by more than one witness that there is a feeling of resentment amongst ex-service men at paying taxes to provide the interest on a debt which was created by the War, but which is largely held by those who by reason of their age were themselves exempt from fighting service. We recur to this point in our discussion of a Capital Levy (*see paras.* 183 *and* 190).

32. On the other hand, it has been put to us that these arguments rest upon a misapprehension, inasmuch as what is alleged regarding the debt is equally true of all capital, or at least of all such as is invested in gilt-edged securities. If there were no National Debt, it is contended, those who subscribed to the Government loans at the time of issue would have found another investment for their money, while those who now hold the National Debt would instead be holders of some other security,

the interest upon which would be neither more nor less a tribute to the richer and to the less active elements in the community.

33. That payments by way of interest upon capital generally go more into the pockets of the well-to-do than of the poor, and, in the case of gilt-edged investments, largely into the pockets of non-producers, is, we think, an obvious consequence of the existing distribution of the ownership of capital in this country. None the less, payments of interest upon the debt stand in a category by themselves, since the *source* of those payments differs from the source from which interest on capital generally is provided.

34. The debt being, as we have already pointed out, the result of economically unproductive expenditure, its service becomes a charge upon the existing revenues of the country. Other interest-bearing capital is, however, generally invested in enterprises in which it is used by productive workers as an instrument in increasing the national output. Out of this increase a part goes in interest to the owners of capital, while the rest is distributed in other ways. Payment of such interest does not involve any fresh charge on the existing national revenues, but is drawn from the increase in those revenues which is created by the use of the capital on which interest is paid.

35. In other words, had there been no debt, the present debt holders would, we agree, have made larger investments (though we think it is an exaggeration to say larger by the full amount of the debt) in other directions. Their receipts in interest might have been nearly as great as at present; but the national production would also have been greater, and consequently the burden on the community of providing these receipts would have been correspondingly less. The general distribution of income is not affected by an increase of income distributed in the same proportions as income already existing; it is affected by the transfer of existing income from one section of the population to another. The service of capital productively invested involves the former; the service of the debt involves the latter.

36. We are anxious not to be misunderstood on this point. We do not suggest that the holders of War debt are in some mysterious way less meritorious than other owners of capital, or that they are "drones" in a sense in which other *rentiers* are not drones. We are concerned only with estimating the burden of the debt, and *we submit that the burden upon the community of providing interest upon capital which has not been productively employed is necessarily greater than in the case of capital which has been so used.*

37. As regards the remainder of the debt, we think that what we have said above is also broadly true of that part which is held by joint stock companies, banks other than savings banks, and, to a limited extent, insurance companies. The interest

paid upon this debt goes ultimately to the benefit of the shareholders of these enterprises; and, since the ownership of capital is in the main concentrated within a relatively small class of more than average wealth, (according to Professor Henry Clay's estimate over two-thirds of the national capital is held by less than 2 per cent. of owners of capital), the effect of these payments, as of the payment of interest upon such part of the debt as is in individual hands, is to make the distribution of wealth more unequal.

38. It is probable, however, that, in the case of the debt held by companies, there is less reason to suppose a transference from the active to the passive. The holders of Government stocks are likely to comprise a larger proportion of persons who have retired from active participation in industry and commerce, or who have never engaged in such activity, than are the holders of industrial securities generally.

39. In the case of insurance companies, some part of the debt interest may accrue to the benefit of policy holders—in which case it seems to us impossible to estimate what the effect of the transfer upon the distribution of wealth may be.

40. Similarly in the case of the railway companies, we find it impossible to estimate the effect of the transfer involved by payment of interest upon the debt. Since the railways are by statute limited to a certain standard net revenue, it cannot be said that the interest upon such part of the debt as they hold goes to the enrichment of railway shareholders. Presumably it ultimately redounds to the advantage of the railway users, but the effect in this direction is evidently remote and small.

41. That part of the debt which is held by savings banks moderates rather than aggravates the inequality in the distribution of wealth. The interest paid upon it goes to the credit of savings bank depositors, who are predominantly representative of the less affluent classes in the community. The same thing is true also of the debt held by Trade Unions and kindred societies.

The Floating Debt.

42. The effects of the Floating Debt are of a special character. We have already indicated that a part of this debt, being held by the Government itself, is, as it were, fictitious. The remainder of the Floating Debt is important, not for its effects upon the distribution of wealth and income throughout the community, which are probably negligible, but for its influence upon the general credit of the Government, and upon the cost of the debt service as a whole. While interest rates are falling, if a large proportion of the total debt is in the form of Floating Debt, substantial reductions are possible in the interest charge; for terms more favourable to the Government

can be obtained week by week as each block of Treasury Bills falls due for renewal. In point of fact, interest on the Floating Debt has for considerable periods been under 3 per cent.

43. On the other hand, the Floating Debt has considerable dangers of its own. Just as constant renewal of the debt enables the Government to take advantage of favourable conditions, so it may create an awkward situation in conditions of the opposite kind. Should the Government itself require large additional borrowings for any purpose, or should there be heavy trade demands for money forcing up interest rates, the renewal of the Floating Debt may prove expensive and difficult and damaging to the national credit. For this reason, in spite of the potential cheapness of the Floating Debt, we think it important that the amount of debt which is retained in this form should be strictly limited. The exact amount which the Floating Debt may, with safety, be permitted to reach at any time can, we think, only be decided in the light of the circumstances of the moment.

Conclusions as to Effects of the Debt upon Distribution of Wealth and Income.

44. Having regard to the large amount of debt held by private persons and by the banks; to the probability that a large part of the £1,650 millions of debt which Mr. Layton estimates to be in the hands of trade unions, foreigners, charities and joint stock companies is, in fact, held by the last-mentioned group; and to the very small part of the debt, the interest upon which can definitely be said to go into the hands of the less well-to-do classes; *we think that it is beyond question that the internal debt involves on balance a transfer of wealth such as aggravates the existing inequality in distribution of income, and tends to increase the proportion of the national income which finds its way into the hands of non-producers.*

45. It appears to us, therefore, that there is justification in fact for the popular idea, to which we have already referred, that a chief part of the burden of the internal debt lies in its effects upon the distribution of wealth and income throughout the community.

The Debt and the Price Level.

46. We have indicated the directions in which, in our opinion, the existence of the debt is chiefly injurious to the welfare of the country. Since the debt is fixed in terms of money, the extent of this injury in the future depends upon the future value of money. We have already shown how variations in the value of our creditors' currency may influence the burden of the external debt.

47. Similar and no less important considerations, however, affect also the burden of the internal debt. Any fall in the general price level at home, which is not accompanied by an exactly proportionate increase in the productivity of British labour, involves an increase in the burden of the internal debt; while any rise in our general price level, unaccompanied by a proportionate diminution in productivity, lightens the burden of the debt at the expense of the whole class of debt holders, as well as of all recipients of fixed incomes.

48. We doubt if it is generally appreciated how seriously the burden of the debt has been increased in the past few years owing to the rise in the value of money. In the following table we show year by year the total nominal amount of the debt; the nominal amount of the debt other than floating, foreign and pre-war; and this last expressed in 1913 prices.*

Date.	Debt, other than Floating, Foreign and Pre-war.	Total Debt.	Statist Index Number at 31st March. (1913 = 100).	Debt, other than Floating, Foreign and Pre-war, expressed in 1913 prices.
	(£ thousands).	(£ thousands).		(£ thousands).
31st July.				
1914 ... (approx.).	—	645,000,000	96·9	—
31st March.				
1915 ...	399,091	1,104,967	122·0	327,124
1916 ...	1,141,190	2,133,148	153·4	743,931
1917 ...	2,597,658	4,011,446	198·8	1,306,669
1918 ...	3,349,211	5,871,851	221·2	1,514,110
1919 ...	4,392,879	7,434,949	217·3	2,021,573
1920 ...	4,955,182	7,831,744	308·0	1,608,825
1921 ...	4,848,130	7,585,410	208·5	2,325,242
1922 ...	5,235,995	7,676,295	156·8	3,339,283
1923 ...	5,478,934	7,772,397	156·1	3,509,887
1924 ...	5,452,856	7,680,623	161·2	3,382,665
1925 ...	5,455,765	7,646,372	164·8	3,310,537

49. It will be seen that in March, 1920, the Statist index number (on the basis 1913 = 100) stood at 308·0, whilst in March, 1925, it had fallen to 164·8. *Between these two dates, therefore, the value of every pound paid in interest upon the debt increased by about* 87 *per cent.* During the same period the nominal value of the internal debt, other than floating and pre-war, also increased slightly, with the result that the total value of this debt, expressed in 1913 prices, was actually more than double in March, 1925, what it had been in March, 1920.

* We have not converted the floating and foreign debt to pre-war prices since the burden of these is not affected by the fluctuations of past British price levels; and we have omitted pre-war debt since this is comparatively negligible in amount and has, of course, been affected by variations in the price level over a very much longer period than the rest of the debt.

50. Since there was certainly no corresponding increase in the national income during the same period, *it follows that (apart from reductions in the interest charge due to repayments and conversions) the real cost to the nation of financing the debt was also about doubled in the five years to* 1925.

51. The obverse of this increase in the real cost of interest on the debt to the nation is the enjoyment during the same period by the State's creditors *as a class* of an " unearned increment " owing to appreciation of the real value of their holdings. By this we do not, of course, imply that every present War Loan holder has enjoyed an increment exactly corresponding to the fall in prices; indeed, in view of the fact that War Loans are constantly changing hands, it is extremely unlikely that this will be the case in any particular instance. Nor, in consequence of the various conversions of one issue into another which have been effected, is it possible to relate with accuracy the present real value of each part of the debt to the value of the money which was originally subscribed for it.

52. *A rough estimate of the position up to* 31*st March*, 1925, *made by the Treasury, indicates, however, that over two-thirds of the post-war debt was raised when the value of money was lower than at* 31*st March*, 1925, *while the remainder was raised when the value of money was higher than it was at that date.* Holders of the pre-war debt have, of course, up to the present, suffered a considerable " decrement " as compared with their position at the outbreak of war.

Future Movements of Prices.

53. In our judgment, the evidence available is not sufficient to permit of reasonably trustworthy estimates being formed as to the course of prices for more than very short periods ahead. On this point, therefore, we only wish to express the negative opinion that we cannot confidently anticipate prolonged stability of prices. We are of opinion that this uncertainty as to prices constitutes an important additional reason for reducing the debt as rapidly as possible. It is undesirable that the burden upon the whole nation should be allowed to increase, as it will if the level of prices falls without any corresponding increase in the national income. It is equally undesirable that a diminution of the burden should be purchased at the sole expense of the recipients of fixed incomes, as it will if the level of prices rises without any corresponding decrease in the productivity of our industry.

Comparison with the Period following the Napoleonic Wars.

54. Witnesses have frequently recalled to us the conditions prevailing immediately after the Napoleonic Wars, pointing out

how a debt which was about equally burdensome in relation to the wealth and population of the time, subsequently became of relatively small importance (although no large efforts were made to reduce it) owing to the growth of the nation in numbers and in prosperity. What has happened before, it has been suggested, may very well happen again.

55. The following table gives an estimated comparison of certain factors in the position in 1818 and in 1923 :—

Ratio to National Income of:	1818.	1923.
	Per cent.	*Per cent.*
Tax Revenue	14·07	18·89
Debt Interest—Internal	7·82	7·14
Foreign	—	·94
Debt Repayment—Internal ...	·30	·75
Foreign ...	—	·30
Deadweight Debt—Internal ...	210·0	173·47
Foreign ...	—	29·16

56. It will be seen that the total debt of 1923, as well as the cost of interest thereupon, bears very much the same ratio to the total national income as did the debt of 1818 to the income of that date.

57. There are, however, certain differences between the two periods. In the first place, a century ago we had no external debt. Second, in the estimates of total national income upon which the foregoing figures are based, the figure for the national income includes interest on the internal debt and war pensions, together with other items such as old age pensions. These items, while they add to the national money income and are subject to taxation, do not represent any present production of goods and services, and are not, therefore, strictly part of our real income. Such items constitute a much larger proportion of the whole national money income in 1923 than they did in 1818. If, therefore, a comparison could be made between the ratio of the debt and debt service to the *real* national income (i.e., such part of the total national money income as represents actual economic production) it would be found that the ratio is decidedly higher than it was a century ago.

58. Further, behind this general similarity between the ratio of debt and debt service to national income to-day and a century ago, there lie differences in other economic conditions which are of at least as great importance.

59. In the first place, we have no reason to anticipate a continuance of the exceptionally rapid growth of population which took place during the last century, greatly reducing the burden of the National Debt per head, and being perhaps a contributory cause of the notable expansion of our wealth during the same

period. On this subject we have heard expert evidence from Professor A. L. Bowley. According to Professor Bowley's calculations the rate of increase of our population is declining, and the indications are that we are tending towards a stationary population. On the assumption that the number of births remains as at present, (in point of fact its tendency is to fall), and that emigration continues on a moderate scale, Professor Bowley calculates that our population would be very nearly stationary by 1951 and quite stationary by the end of this century.

60. Further, on the assumption that the number of births is stationary, 20 years or so hence a larger proportion of the population will be found in the higher age groups, i.e., either outside the working population altogether, or in those age groups which experience has shown have the greatest difficulty in obtaining permanent productive employment.

61. It would seem, therefore, that, first, we cannot expect any large increase in our population during the next half century, even supposing (which we do not wish to be understood to admit) that this would be accompanied by a sufficient increase of wealth to make the reduction in the debt-charge per head of population a real as well as an apparent relief; and, second, that such increase as may be expected is likely to occur predominantly among the sections of the population who are at non-productive ages.

62. Again, a century ago we were in the midst of a stream of new inventions and important changes in industrial technique, and had also something like a monopoly of the new methods. While we do not suggest that the stream of invention has run dry, we see no reason to anticipate that history will repeat for our benefit an episode which was plainly of an exceptional character.

63. On the prospects for the future it is impossible to be dogmatic, least of all without a searching investigation into the whole position of British industry such as would be altogether outside our province. We think, however, that we have said enough to make it beyond doubt that he who relies for relief from the burden of debt upon a repetition of nineteenth century economic history in the twentieth century is at best gambling upon a most uncertain chance. Nor should it be forgotten that, unless our currency is deliberately expanded to counteract this result, an increase in the national income will be accompanied by a fall in the general level of prices. An increase in production, however, if accompanied by an equivalent fall in prices, leaves the burden of the debt in relation to the national income exactly where it was.

ANNEXE TO PART I.

Table showing the Composition of the National Debt and Dates of Maturity of Various Loans. (Approximate totals at 31st March, 1926.)

Year of Maturity.	Security.	Internal.	External.	Total.
		£	£	£
1926-27	5% Treasury Bonds ...	109,632,000	—	112,714,000
	Central Argentine Railway Co., $15,000,000	—	3,082,000	
1927-28	4% and 5% National War Bonds and 3½% War Loan.	300,814,000	—	300,814,000
1928-29	4% and 5% National War Bonds.	467,590,000	—	470,931,000
	5½% Straits Settlements Dollar Loan.	—	3,341,000	
1929-30	5½% Treasury Bonds and 3% Exchequer Bonds.	46,277,000	—	54,603,000
	5½% 10-year Bonds, $19.522,500.	—	4,011,000	
	5% Straits Settlements Dollar Loan.	—	4,315,000	
1930-31	5½% Treasury Bonds ...	134,741,000	—	134,741,000
1932-33	4½% Treasury Bonds ...	121,266,000	—	121,266,000
1933-34	4% and 4½% Treasury Bonds.	85,156,000	—	86,909,000
	5% Straits Settlements Sterling Loan.	1,753,000	—	
1936-37	5½% 20-year Bonds $143,587,000.	—	29,504,000	29,504,000
1940-41	Anglo-French Loan 4½% Bonds, $13,850.	—	3,000	3,000
1942-43	4% War Loan, 1929-42 ...	64,915,000	—	64,915,000
1944-45	4½% Conversion Loan ...	210,587,000	—	210,587,000
1945-46	4½% War Loan	12,804,000	—	12,804,000
1947-48	5% War Loan	2,044,053,000	—	2,044,053,000
	4% Victory Bonds * ...	347,609,000	—	347,609,000
	4% Funding Loan * ...	391,910,000	—	391,910,000
	3½% Conversion Loan* ...	760,015,000	—	760,015,000
	Consols, etc....	313,505,000	—	313,505,000
	Terminable Annuities ...	12,639,000	—	12,639,000
	Treasury Bills	564,855,000	—	564,855,000
	Ways and Means Advances	139,441,000	—	139,441,000
	National Savings Certificates	375,571,000	—	375,571,000
	Loans from certain Allied Governments	—	135,700,000	135,700,000
	U.S.A. Government Loan*—$4,530,000,000	—	930,822,000	930,822,000
	Total outstanding on 31st March, 1926	6,505,133,000	1,110,778,000	7,615,911,000

* These loans are being repaid by specific statutory Sinking Funds.

The above table takes no account of the premiums due upon repayments of certain issues of National War Bonds. The possible amount of such premiums is estimated as being in the region of £30,000,000. This is, however, a somewhat theoretical figure, since many of these Bonds will certainly be converted before maturity.

Second, the table takes no account of the liability for accrued interest on National Savings Certificates. These are entered at their face value at the time of issue, viz., 15*s.* 6*d.* in the case of the earlier, and 16*s.* in the case of the later issues. Allowance is made in the Budget estimates for each year for the interest expected to be paid on certificates actually cashed during the year, but no allowance for the accruing liability is included in statements of the National Debt. A foot-note to the Finance Accounts shows that the approximate liability for interest accrued on certificates outstanding was £100 millions on the 31st March, 1926.

PART II.

TAXATION.

General Incidence of Taxation.

64. The terms of reference of the Committee require the investigation, not only of the National Debt itself, but also of the incidence of existing taxation—of which, as we have shown, a very large part is required to meet the cost of the debt.

65. In Section III of the Majority Report will be found an analysis of the proportion of income paid in taxation by families in receipt of incomes of different sizes, on the lines of the calculations made by Mr. (now Sir Herbert) Samuel in 1919. The assumptions made in constructing the tables shown on pages 94 to 96 are explained in the Majority Report.

66. The calculations involve so many doubtful assumptions that we do not think the figures should be taken otherwise than as a broad, general indication of the distribution of tax burdens. As such, however, they appear to us to show some disquieting features. *The burdens of taxation on family incomes of* £200 *and under (as shown in the first table) are evidently very heavy.* The percentage taken by taxation from such incomes appears to be of the order of 10 per cent. to 13 per cent., which we can only regard as unjustifiably high.

67. Family incomes of £200 per annum and under cannot be said to leave any appreciable margin over the bare needs of healthy and civilised living, and are not fit subjects for taxation on the scale which these figures indicate. Moreover, with wages at their present level, such incomes are by no means exceptional. If the figures give a reasonably accurate view of the position, *we can only infer that a considerable part of the wage-earning population must be seriously overtaxed.*

68. We notice also that the comparable figures suggest that taxation on the lower "middle-class" incomes of about £500 is moderate in comparison with that levied on incomes of the wage-earning level. Even incomes of £1,000 show very little progression as compared with those of £100-£200. In view of the widespread belief that existing taxation presses with exceptional weight upon the middle class, we wish to call special attention to the somewhat unexpected result shown by the figures.

The Principle of Taxation upon Commodities.

69. Although substantial reductions have been made in recent years in the rates of indirect taxation upon certain commodities, new duties have been introduced, and a very large proportion

of the total tax revenue is still raised by this means. The estimates for the current year show that out of a total tax revenue of £691 millions, £250 millions, or 36 per cent., are to be raised by Customs and Excise duties.

70. We have found very little support, but much condemnation, among witnesses for indirect taxation in principle. *We are ourselves of opinion that taxes upon commodities, regarded as part of a general system for raising the money required for State expenditure, are objectionable in principle, and that the important place which they occupy in our tax system can only be defended on the ground that they are survivals from a period when the administration of direct taxation was much more difficult than it is to-day.*

71. Our objection to indirect taxation rests primarily on its necessarily regressive character. The effect of such taxation is, except in special circumstances, to raise the price of the taxed articles, and its primary incidence is accordingly upon the consumers of such articles. If any substantial amount of revenue is to be raised by indirect taxes, these must necessarily be imposed upon articles of general consumption. It follows that such taxes must be regressive in character, since the poorer classes of the community of necessity spend a larger part of their incomes upon commodities of general consumption than do those who are better off.

72. It is in fact simply the large amount of commodity taxation in force which is responsible for the regression revealed by the tables in the existing tax system on the lower ranges of income. We doubt if any defence in principle can be found for raising revenue by taxation of a character which presses more heavily upon the poor than upon the rich—least of all in a community which presents such extreme contrasts of wealth and poverty as does our own. *Taxation should mitigate, not aggravate, inequality in the distribution of income.*

73. The general objections to indirect taxation apply with special force to the taxes upon food, upon entertainments, and upon artificial silk. The food taxes, in particular, of which the most burdensome is the tax on sugar, must be paid by even the poorest section of the community, upon whom indeed they press with exceptional severity. They are thus exceptionally regressive, and they take no account of a principle which we regard as essential to any equitable system of taxation, viz., that *taxation should not be imposed upon any whose means are not adequate to maintain a certain minimum standard of living.*

74. Moreover, such taxes necessitate a restriction of consumption upon articles of which we think all consumers should be free to purchase as much as they require. Witnesses representing the Parliamentary Committee of the Co-operative Congress, speaking on behalf of an organisation engaged in supplying the everyday needs of a very large number of working-class

households, gave evidence before us of the restrictive effect upon consumption of the taxation upon sugar and tea. They stated that, on information received from retail Co-operative Societies, whose members, with their families, number about 3,000,000 persons, the reduction in taxation on tea and sugar under the Budget of 1924 was immediately passed on to consumers, and that trade immediately expanded. While " the expansion was not uniform throughout the country, ... an increase of 10 per cent. in the sales of tea and of 5 per cent. to 10 per cent. in the sales of sugar may be taken as typical." During the 14 weeks immediately following these budget reductions, the English and Scottish Wholesale Societies' sales of tea increased by 16·3 per cent., as compared with the corresponding period of 1923, and by 23·8 per cent., as compared with the immediately preceding 14 weeks; while their sales of sugar increased by 24 per cent., as compared with the corresponding period of 1923, and by 26·5 per cent., as compared with the immediately preceding 14 weeks. (*Co-operative Congress, Ev. p.* 306, *E. in C.*, 25 *and* 26.)

Recommendation as to Indirect Taxation.

75. *We recommend, therefore, that, subject to the needs of fresh expenditure, any future surplus of revenue should be devoted to abolition primarily of the food duties, and thereafter of the duties upon entertainments and upon artificial silk. We are of opinion that these reductions should take precedence of any further reductions of direct taxation.*

76. We are prepared to admit that, on occasion, commodity taxation may be the most convenient method of regulating or restricting the production of particular articles. We think, however, that such cases are few. We do not, for instance, think that they include so-called " luxury taxation on expensive articles." In our view, luxurious expenditure should be limited by measures designed to secure a more equal distribution of wealth, and not by selecting particular articles (which are no more obnoxious than many others) as objects of luxury taxes. Our recommendations, however, in regard to commodity taxation are directed not so much to the imposition of particular taxes primarily for other than revenue purposes, as to the use of such taxation as an important instrument of revenue.

Taxation and Representation.

77. It is evident from what we have already said that we attach no importance to the maintenance of any particular ratio between the sums raised by direct and indirect taxation. No scientific argument has been put forward in favour either of the old-fashioned 50 : 50 ratio (from which this country has now long since departed), or of any other proportions. We agree with Mr. McKenna that the proportion observed is wholly a matter of expendiency. (Q. 1983.)

78. We are aware that even the abolition of the food taxes alone would enable a section of the community to escape national taxation altogether, and that the complete abolition of commodity taxation as an instrument of revenue would place large numbers of electors in that position. It has been put to us that members of the electorate, whatever their economic position, ought not to be wholly exempt from taxation, on the ground that, in this event, their votes will not be exercised with a due sense of responsibility.

79. We attach little importance to this argument. In the first place it appears to us difficult to press the principle of "no representation without taxation" so long as the converse principle of "no taxation without representation" is not observed, as is the case to-day with considerable numbers of women taxpayers. Secondly, the whole argument seems to us to be of a somewhat academic character. We suggest only that those citizens should be exempt from taxation whose means are inadequate to support a reasonable standard of life.

80. We think that the effects of good or bad government are more marked in the lives of the poorest classes than in the case of any other section of the community; and that the less fortunate electors appreciate their responsibility as electors far more keenly on this account than through payment of a few shillings in indirect taxation, as to the very amount of which they are frequently in ignorance. In our view, society has already exacted sufficient sacrifice from those who, in the conditions that society permits, have been unable to attain a minimum standard of civilised existence.

Direct Taxation—General.

81. We have heard a very great deal of evidence dealing with the effects of existing direct taxation upon industry and trade. That such taxation is highly injurious has been very strongly urged upon us by many witnesses who have had wide experience in industry, commerce and finance. We have accordingly thought it proper to give special consideration to this subject and have set forth our conclusions in some detail below.

82. At the outset we think it desirable to mention that we have had practically no *quantitative* evidence upon this subject. The tendency of witnesses was to argue that existing taxation is injurious and to indicate the kind of injury for which, in their opinion, it is responsible, without relating this to particular rates of taxation or expressing any opinions as to *how great* a benefit or additional injury would be caused by a given reduction or increase in existing taxes. In particular, the evidence has extended over a somewhat lengthy period during which the rates of direct taxation have been appreciably reduced under the Budget of 1925. We have not observed that this reduction has in any way modified the evidence of witnesses whose evidence we have heard since it took effect, or that those whom we heard

earlier would regard the opinions which they expressed when the rates of 1924-25 were in force as inapplicable to the conditions of 1926-27.

83. During the present century the maximum direct taxation levied upon any part of an individual income has ranged from 11*d.* in the £ in 1903-04 to 12*s.* in 1920-21, while the scale of death duties has also been increased from a minimum Estate Duty charge (on unsettled estates) of 8 per cent. prior to 1907 up to a maximum of 40 per cent. at the present time. Throughout this period, however, responsible persons have constantly expressed the opinion that the level of direct taxation was excessively high.

84. In 1907 a permanent Income Tax of 1*s.* in the £ was "a deplorable thing."* Any Income Tax "as high as 1*s.*" reacted "directly upon the amount of employment for the people of this country."* The tax was also characterised as likely to drive capital abroad† and as a "very dangerous departure,"‡ only to be defended as "an emergency tax."‡ In 1909 it was said of an Income Tax of 1*s.* that it "abolishes the reserve fund of the country"§ and "affects both profits and wages."§ In 1909 it was believed that the proposal to increase Estate Duty (to a maximum charge of 15 per cent. on unsettled estates) would "lead to a very considerable depletion of capital" which could "only be accompanied by scarcity of employment, growing greater from one year to the other."‖

85. We quote these statements, to which it would be easy to find parallels relating to any other rates of tax that have been in force during the present century, as indicating that, in the opinion at least of contemporary taxpayers, the injurious effects, which it has been put to us result from direct taxation upon the existing scale, have been associated no less with direct taxation on a very much more moderate scale.

86. We do not doubt that there is a natural and inevitable tendency on the part of the taxpayer to regard all taxation that has not lately been reduced, whatever its level, as unjustifiably burdensome to himself and injurious to the well-being of the country as a whole. In any scientific enquiry, it is important to disregard generalisations arising solely from this tendency, and to confine attention to arguments which indicate with some precision both the *qualitative* effects of all direct taxation upon the national well-being, and, *quantitatively*, how far the magnitude of these effects depends upon the maintenance of such taxation at a given level. In the following paragraphs we have endeavoured to analyse such arguments as carefully and exhaustively as we can.

* Mr. (now Sir) Austen Chamberlain. Hansard, 22/4/07, 1439 and 1440.
† Mr. (now Sir) Austen Chamberlain. Hansard, 22/4/07, 1446.
‡ Mr. Evelyn Cecil. Hansard, 22/4/07, 1479.
§ Mr. (now Sir) William Joynson Hicks. Hansard, 17/5/09, 112.
‖ Mr. J. F. Mason. Hansard, 20/5/09, 586.

Direct Taxation and Employment.

87. If the contention that direct taxation is highly injurious to trade and prosperity is valid, we should expect to find some correlation between movements in the level of such taxation and movements in the rate of unemployment. We have, accordingly, had prepared the following table and diagram showing from 1890-91 to 1925-26 the level of direct taxation per head (both actual and converted to a uniform price level), the percentage of total tax revenue raised by direct taxes and the Trade Union unemployment percentage.

Table showing yield of Direct Taxation per head; yield divided by Statist Index of Prices; and Trade Union Percentage of Unemployment from 1890-91 *to* 1925-26.

Period.	Direct taxation per head.	Percentage of total Tax Revenue.	Statist Index No. (1867-77 = 100).	Direct Taxation per head on basis of Statist Index No. (1890-91 = 71·5) (Financial Year).	Trade Union Percentage of unemployed. (Calendar Year).
	£ s. d.			£ s. d.	
1890-91	18 11	44·1	71·5	18 11	2·1
91-92	19 6	44·3	71·2	19 7	3·5
92-93	18 11	44·1	68·0	19 11	6·3
93-94	19 3	44·7	67·0	1 0 8	7·5
94-95	1 0 0	45·4	61·8	1 3 2	6·9
95-96	1 2 5	47·6	62·2	1 5 9	5·8
96-97	1 2 7	47·4	61·1	1 6 5	3·3
97-98	1 3 6	47·9	62·4	1 6 11	3·3
98-99	1 3 11	48·2	64·7	1 6 5	2·8
1899-1900	1 5 9	48·4	70·5	1 6 1	2·0
1900-01	1 8 9	49·4	74·3	1 7 8	2·5
01-02	1 13 1	52·5	69·5	1 14 0	3·3
02-03	1 14 5	52·4	69·7	1 15 4	4·0
03-04	1 9 7	49·3	69·8	1 10 4	4·7
04-05	1 9 11	49·5	70·7	1 10 3	6·0
05-06	1 9 10	50·3	73·4	1 9 1	5·0
06-07	1 10 6	51·4	78·2	1 7 11	3·6
07-08	1 10 4	51·1	78·4	1 7 8	3·7
08-09	1 9 11	52·6	72·6	1 9 6	7·8
09-10 / 1910-11	1 15 6	56·4	77·0	1 12 8	7·7 / 4·7
11-12	1 19 0	57·3	80·9	1 14 6	3·0
12-13	1 19 3	57·6	86·0	1 12 8	3·2
13-14	2 1 0	57·5	84·4	1 14 9	2·1
14-15	2 9 7	60·1	89·7	1 19 6	3·3
15-16	3 16 0	60·2	113·6	2 7 10	1·1
16-17	8 11 0	76·3	144·9	4 4 5	0·4
17-18	11 0 6	82·7	180·6	4 7 4	0·7
18-19	13 11 5	79·5	192·7	5 0 8	0·8
19-20	15 12 9	72·0	222·5	5 0 6	2·4
1920-21	15 0 6	68·2	230·6	4 13 2	2·4
21-22	11 6 10	62·7	146·4	5 10 9	15·3
22-23	11 4 2(a	64·4	131·8	6 1 7	15·4
23-24	10 2 11(a	63·4	131·5	5 10 4	11·5
24-25	10 6 10(a	66·7	141·2	5 4 9	8·1
25-26	9 19 7(a	64.6	130·5	5 9 4	10·5

(*a*) Excluding Irish Free State.

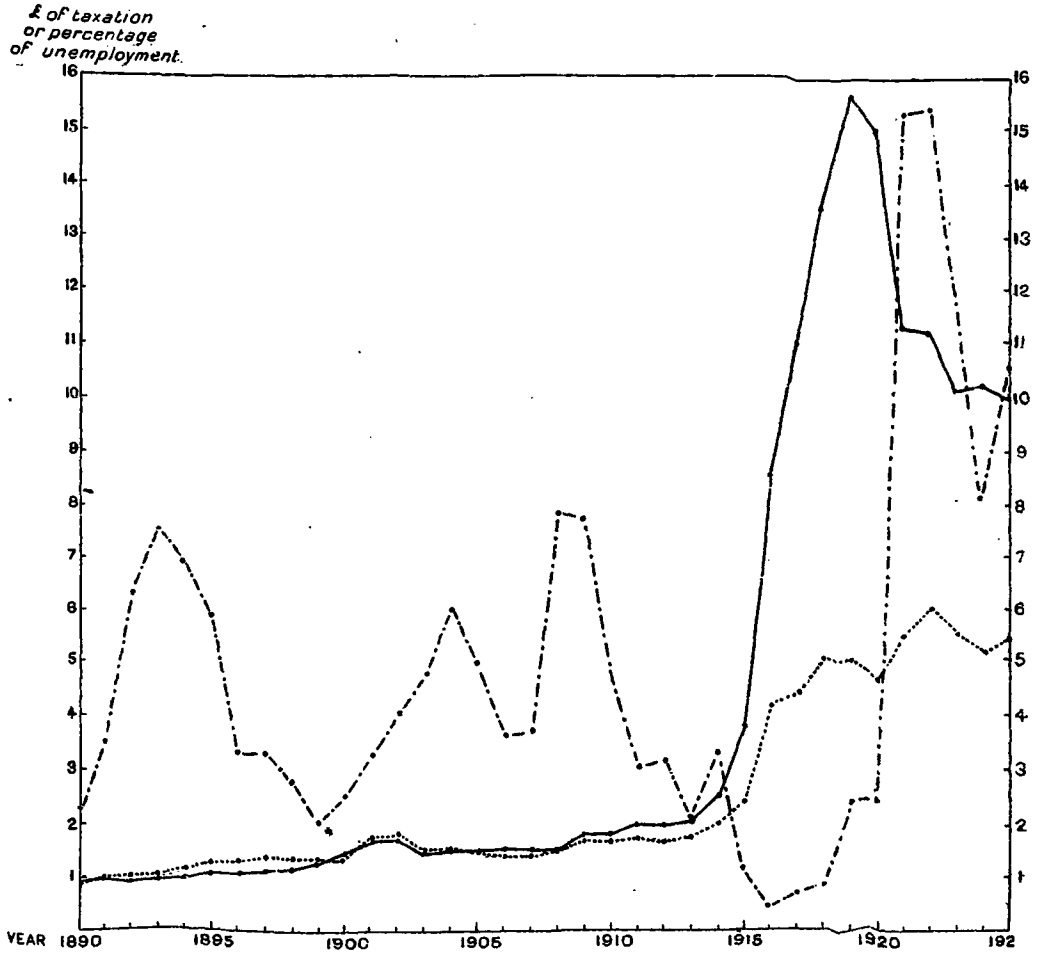
(NOTE.—Excess Profits Duty is included under the head of direct taxation.)

DIAGRAM SHOWING

DIRECT TAXATION PER HEAD. ——————

DIRECT TAXATION PER HEAD ON BASIS OF STATIST INDEX. ……

TRADE UNION PERCENTAGE OF UNEMPLOYED. – – – – –



(For taxation statistics the year is the financial year commencing 1st April, for the unemployment percentage it is the calender year)

448 (3944) 4365. 3000. 2. 21. Malby & Sons, Lith

88. *This table shows absolutely no ground for believing that direct taxation has been a material factor in causing unemployment.* There is no significant correlation whatever between the figures. In 1890-91 the unemployment rate was 2·1 per cent., while direct taxation per head was 18*s.* 11*d.* In 1919-20 unemployment was only 2·4 per cent., but direct taxation, at the prices of 1890-91, amounted to £5 0*s.* 6*d.*, and, in the actual money of the time, to £15 12*s.* 9*d.* Again, direct taxation at less than 20*s.* per head is found coinciding in various years with unemployment rates ranging from 2·1 per cent. to 7·5 per cent.

89. We do not find the results shown by this table difficult to reconcile with the conclusions to which general reasoning leads; for, as shown below, we do not think that there is adequate ground for the general contention that direct taxation, imposed on any scale which we have so far experienced, and devoted to the objects by which it is at present absorbed, is likely to be injurious to prosperity and employment.

90. This contention appears to be supported on five principal grounds. First, it is thought that direct taxation reduces the community's purchasing power. Second, it is urged that direct taxation inflates prices, thus handicapping this country in competition with less heavily taxed producers abroad, as well as limiting the market and oppressing the general mass of consumers at home. Third, direct taxation is thought to deter the taxpayer from exerting as much productive effort as he would if the State abstracted a smaller share of the proceeds. Fourth, our direct taxes are said to reduce the quantity of new saving and investment by destroying at once the taxpayer's incentive and his capacity to save. Fifth, existing direct taxation is said to impair the quality of investment because it reduces the rewards of risky enterprise and so encourages a preference for gilt-edged, as compared with industrial, investments.

Direct Taxation and Purchasing Power.

91. The view that direct taxation (other than that levied for the service of the external debt) actually reduces the aggregate purchasing power of the community appears to us to be entirely a misconception. Witnesses who have expressed this view have apparently concentrated their attention upon the obvious effects of taxation in impoverishing the taxpayer; but have omitted, in estimating the effect upon the community as a whole, to take into account the fact that other people—the State's agents or the beneficiaries of various forms of public expenditure—have power to spend all the purchasing power that the taxpayer loses. All taxation, whether for debt interest, debt redemption, the social services, national defence, or any other object, involves a transfer, but no reduction, of aggregate purchasing power.

92. A belief that taxation actually reduces the aggregate volume of purchasing power plays a large part, we think, in creating the fears that are commonly expressed that the existing level of taxation is an important cause of unemployment. In our opinion, these fears are greatly exaggerated. Since taxation (whether it takes 5 per cent., 10 per cent., 20 per cent. or 100 per cent. of the taxpayer's income) neither destroys any part of the national money income nor seriously delays the rate at which this is actually spent, (the State normally pays out what it receives from the taxes at least as rapidly as private persons spend their incomes), it cannot be said to cause unemployment by reducing the amount of purchasing power actually available at any one moment for expenditure upon the goods and services which workers are employed to produce.

Direct Taxation and Prices.

93. The contention that direct taxation raises prices is in general confined to the Income and Super-taxes, to the exclusion of the death duties. It is argued that producers aim at obtaining a given net return on their capital and efforts, and that, if this return is reduced by increased direct taxation, they will put up prices to recoup themselves for the difference. On this view, the tendency of direct taxation is always to operate in this way; and the level of taxation is now such that the resulting effect on prices may be said to be definitely injurious.

94. We are unable to accept this doctrine. We are of opinion that it is only in very exceptional cases that manufacturers and merchants are able to pass their Income Tax on to consumers through the prices of the goods that they sell. On this subject we are in substantial agreement with our colleagues. For the sake of completeness, however, we recapitulate briefly here the main reasons which have led us to this conclusion.

95. Fundamentally, it appears to us that all businesses try to charge prices which, in conjunction with their total sales, will yield a maximum profit upon their capital. This is true of all conditions, from a complete monopoly, in which one firm has power to maintain prices at whatever level it may choose, to a keenly competitive industry, in which any firm that charges more than the ruling prices loses business to its competitors. In so far as merchants and manufacturers are already getting the best profit that they can, they cannot get a better by putting up their prices. It follows that an attempt to recoup themselves for Income Tax by increased prices will defeat its own ends and will only be carried out under a misapprehension.

96. Further, as regards that part of trade which is still in the hands of private concerns, it must be borne in mind that individual firms are liable to Income and Super-tax at widely differing rates. If these taxes are normally passed into prices, the necessary addition to prices would vary widely in the case

of different firms, and the small private merchant who pays only a very low tax would enjoy a differential advantage over his larger and richer competitor and over the joint stock company. We are unable, however, to find any evidence that small private firms do underbid their competitors in this way.

97. Finally, we are at a loss to see how a general increase of all prices consequent upon increased Income Tax can be sustained, unless the volume of the currency is also increased to meet this. We accept the theory that the general level of prices can only change if there is a change in the volume of money and bank deposits, or in the rate at which these circulate, or if there is a change in the volume of production. We can see no reason whatever to suppose that increased Income Tax will lead to an increase in the amount either of legal tender or of bank deposits, while, if, as is widely believed, a high Income Tax is depressing to trade, it will retard rather than accelerate the velocity at which money circulates.

98. The only remaining way in which increased Income Tax could raise the general level of prices would be by causing a reduction in the volume of production proportionate to the increase in the price level. In this event, however, manufacturers and merchants would lose in reduced sales all that they had hoped to gain in increased prices.

99. *Our conclusions on this head are, therefore, that direct taxation does not normally enter into prices. It follows that the existing level of such taxation cannot be cited as a direct cause either of high prices in this country or of the difficulties which British manufacturers may experience in quoting prices as low as those of their foreign competitors.*

Direct Taxation and the Output of Work.

100. In the second place, it has been repeatedly urged before us that income taxation and death duties on the present scale destroy the incentive to work. The taxpayer does not regard the net return which he can obtain by his efforts as a sufficient inducement to work as long or as intensively as he otherwise would. Other witnesses, on the other hand, have contended that the effect of taxation is exactly the opposite of this, and that higher taxation stimulates harder work, in order to prevent an unwelcome reduction in the taxpayers' standard of living. We have found little attempt to reconcile these two conflicting views, witnesses usually contenting themselves with stressing the one argument and minimising the other.

101. We think it reasonable to suppose that taxation operates differently in the case of different taxpayers, acting as an incentive to work in the case of those who are particularly concerned to maintain a certain definite standard of living, and as a discouragement to others, who can maintain what they regard as

a normal standard without exerting their energies to the full. We should be at a loss to say whether on balance existing direct taxation increases or reduces the taxpayers' aggregate output of productive work.

102. We think, however, that the influence of direct taxation upon the output of work in either direction is insignificant, and that witnesses who have attached much weight to it have not, perhaps, fully appreciated the conditions which recent changes in industrial organisation have created. For, in the first place, *the great mass of the national output of productive work comes from those whose incomes and property are either wholly, or almost wholly, below the level at which liability to direct taxation begins.* It can, therefore, only be within a comparatively small area that liability to direct taxation can either stimulate or discourage productive effort.

103. Second, even within this limited area, we are of opinion that the influence of direct taxation upon the output of work must have diminished greatly in recent years, and can now have but little importance. The arguments which we have outlined above assume that, in the normal case, the direct taxpayer is free to increase or diminish his output of work and his earned income at will. In the statements that have been put before us, illustrations were drawn from the medical, legal or such other professions as are usually remunerated by fees, in which this freedom undoubtedly exists.

104. In the large and growing field of salaried enterprise, however, both work and remuneration (and frequently also the age of retirement) are fixed, and the taxpayer cannot earn more by working harder or longer to compensate for his increased taxation; nor can he reduce his liability to pay taxes by diminishing his output of work, unless he gives up his employment altogether. With the growth of joint stock enterprise it appears to us that the case of the taxpayer who can and does adjust his output of work in accordance with his liability for taxation is so exceptional that it cannot now have any serious effect upon the total national output of productive work.

105. In this connection we think it worth pointing out that, according to the Census figures of 1921, persons described as employers or as working on their own account did not amount to more than approximately 1 in 10 of the occupied population over 12 years of age. Even this proportion would, of course, include a number whose liability to direct taxation was either nil or very small, so that the proportion of the total working population whose output of work is actually affected by the level of direct taxation must be appreciably less than this.

106. Finally, we wish to call attention to the results of an interesting investigation submitted to the Committee by Mr. W. H. Coates on the basis of Inland Revenue statistics. The object of the investigation was to ascertain whether, under the

stress of recent increases in taxation, there was any tendency for wealthy taxpayers to retire earlier in life from active enterprice. Mr. Coates' conclusion was that, after making every allowance, it was " difficult . . . . to find . . . . any statistical support for the view that the weight of post-war taxation tends to deter the wealthy man from continuing in business after reaching an age at which he might well retire." (*Ev. p.* 640; *E. in C.*, 28.)

107. *Our conclusion under this head is, therefore, that direct taxation neither stimulates nor discourages the output of work in any important degree.*

Direct Taxation and the Quantity of Saving.

108. It has been put to us that direct taxation destroys both the incentive and the power to save, and that its effect in these directions is sufficiently great to be seriously detrimental to the expansion of industry and employment.

(i) *The Incentive to Save.*

109. This evidence as to the effect of taxation on the incentive to save, like that dealing with the incentive to work, has been countered by evidence of an exactly opposite character from other witnesses. These witnesses have argued that increased direct taxation strengthens the incentive to save, since it makes a greater accumulation necessary to provide any given net income or capital sum for the future of the taxpayer and his family. In this case also we have been able to obtain little evidence based on a scientific attempt to estimate the quantitative effect of these conflicting influences upon the investing classes generally.

110. Our conclusions, therefore, can only be based upon what appears to us to be a reasonable view of the motives by which saving is most commonly prompted.

111. We think that the most widespread motive of individual saving among all classes who make permanent savings* of appreciable amount is the desire to provide for contingencies, for old age and for dependants; or, in a more limited number of cases, to enjoy the satisfactions attaching to a higher standard of living or a greater reputation for wealth. In addition, a considerable class (which includes, but is not confined to, those who are wealthy enough to find the possibilities of enjoyable consumption more limited than their incomes) act mainly on the principle of maintaining a given or gradually rising standard of present consumption, and accumulating (often for use in expanding their own businesses) whatever margin of their income remains.

* Among the very poor any saving is usually for a rainy day or for a special occasion and is not permanent in character, the money put by being spent when the day comes.

112. Direct taxation reduces the net return obtainable from a given investment. But it only destroys the incentive to save, if the strength of this incentive varies directly with the return obtainable from saving and investing a given sum. If, however, our analysis of the chief motives which induce saving is correct, this is not usually the case. Persons who are making provision for contingencies, or for their dependants, usually aim at achieving a certain sum, or enough to secure a certain minimum income; to them, accordingly, the incentive is actually greater when the return is less. Such persons find indeed that the effectiveness of a given effort on their part to provide for the future is reduced by taxation. But it is difficult to believe that they will in consequence relax their own efforts so as still further to reduce their provision for themselves and their families, as though no bread were better than half a loaf.

113. Again, the motives* of those, who, on the other hand, act on the principle of maintaining a given present standard of living and accumulating the balance of their incomes have obviously no connection with the amount of yield which their savings give.

114. A further point seems to us worth notice. Supposing that the considerations which we have put forward above are not in all cases applicable, and that the incentive to save on the part of some investors *does* vary directly with the prospective net return obtainable, we think that it is clear that such exceptions can only be found among persons of relatively moderate means upon whom the claims of present consumption are very pressing. Only in the case of the " marginal " investor, can it be argued that variations in the return obtainable influence the strength of the inducement to save.

115. The " marginal " investor, however, is not found among the recipients of large incomes. A net return which may conceivably be the minimum required to maintain the savings of a small investor affords a handsome surplus to the well-to-do, whose accumulations involve little effort and are not, therefore, dependent upon the stimulus of so great a return. Existing progressive taxation, however, affects but little the return which a small investor enjoys from a given investment, while it makes an appreciable reduction in the net yield which the recipient of a large income will obtain from a similar investment of like amount. It follows that the influence of taxation upon the yield of investments is only important in the case of those classes whose incentive to save is least likely to be affected by consideration of this yield. We think that this circumstance also strengthens the conclusion which we have formed that existing taxation is not a serious deterrent to saving.

* We should perhaps emphasise that, throughout this section, we are discussing only the *incentives* as distinct from the *capacity* to save.

116. The view that taxation destroys the incentive to save even among the wealthy who pay the heaviest taxes is not by any means universally expressed even by those of our witnesses who might be supposed to be familiar with the psychology of the well-to-do investor. Mr. Gordon Selfridge, for example, gave it as his opinion that " One cannot say that the existing taxes act as a deterrent to the individual or the company from *trying to save* and trying to increase the surplus, but of course it has a very serious effect *on the result of that effort.*" (*E. in C.*, 4.)

117. Mr. Coates, who had six years' experience as Director of Statistics and Intelligence in the Inland Revenue Department,* stated that he did not think that " the existing rates of income taxation act as a deterrent to saving generally, or to enterprise on the part of individuals engaged in trade, whether on their own account, or in the conduct of joint stock companies." (*Ev.*, *p.* 640; *E. in C.*, 26.)

118. We are of opinion that those who have expressed the view that progressive taxation seriously impairs the incentive to save have not appreciated the distinction clearly drawn in Mr. Selfridge's statement between the effects of taxation upon the incentive and upon the ability to save. Taxation by itself (i.e., if the subsequent expenditure of the proceeds of taxation be ignored) obviously limits the individual taxpayer's margin for saving, but, for the reasons given, we do not think that it has any serious effect upon the effort to save within that margin.

119. The foregoing relates to the savings made by individuals. We have, however, also to take into account the considerable sums that are accumulated by joint stock companies in the form of reserves, out of funds which have never been distributed into the hands of individuals.

120. Such savings, being liable only to Income Tax at the standard rate, are not affected by the progressive character of our taxation. If existing taxation destroys the incentive to make savings of this character, this incentive can only be restored either by reduction of the standard rate of Income Tax (to which policy there are obvious limits) or by special discrimination in favour of companies' reserves, which we do not think practicable.

121. In any case, however, we do not think that the motives which induce this kind of saving are of a character likely to be much affected by taxation. Chief among these motives is a desire to provide for the stability and expansion of the individual firms by which the savings are made.

122. The incentive to make allocations to reserve will evidently be affected by matters bearing on the position and prospects of the firm; but since a company, as such, pays the same rate of taxation on all profits, whether distributed or not, we fail to see how the standard of reserve allocations *aimed at* can be

* Mr. Coates' evidence was, however, given in his private capacity.

affected by taxation. In this connection we are much impressed by the remarkable steadiness in companies' allocations to reserve. The investigations into company accounts made by *The Economist,* quoted by Mr. Layton, show that, for the five years before the War, allocations to reserve amounted to 24·4 per cent. of gross total profit, and to 2·3 per cent. of capital; while, in the five years after the War, a similar investigation covering a much larger number of companies showed reserve allocations amounting to 24 per cent. of gross profits and 2·8 per cent. of capital.

(ii) *The Capacity to Save.*

123. It is obvious that direct taxation reduces the taxpayer's capacity to save. It is obvious also that this reduction is greatest in the case of the comparatively wealthy, from whom, under the existing distribution of wealth, the greater part of the total volume of new saving must come. On the other hand, expenditure of the funds raised in taxation increases the wealth, and therefore, the potential capacity to save, of the recipients. The questions that we have to consider are, therefore, first, whether the transfer of wealth effected by existing taxation and existing expenditure, considered together, is on balance a transfer from saver to spender; and, if so, whether the result is to make the total volume of saving only less than it would be were taxation lower, or also less than it should be if the best interests of the nation are to be served.

124. In connection with the first question we think that it is important to bear in mind that, out of a total expenditure in 1925-26 of £754,695,000 on all objects other than the Post Office Services and the Road Fund (neither of which falls upon the general tax revenues), expenditure upon the internal debt services absorbed about £325 millions, or 43 per cent. The direct tax revenues (including under this head all the Inland Revenue duties) amounted, for the same period, to £428,441,000, of which total 43 per cent. or £184,230,000 may be regarded as used for meeting cost of interest on and repayment of the internal debt.

125. This last portion of our tax revenues appears to us to stand in a category by itself. *We can see no reason to suppose that the recipients of National Debt interest and repayments are likely to save a less proportion of these receipts than would have been saved by the taxpayers from whose pockets this money is taken. Indeed we think the probability is rather the other way.* We have already given reasons for supposing that the payment of interest on the National Debt by taxpayers to debt holders is on balance a payment from the community at large to its relatively well-to-do members. If the common assumption is true that the proportion of income likely to be saved is greater in the higher income groups, it follows that a transfer of this kind would, if anything, tend to increase the total volume of saving.

126. The matter is indeed somewhat conjectural, and we are not prepared to say that payment of interest on the internal debt must create a substantial increase in saving in this way. We think, however, that it is at least clear that taxation for this purpose neither destroys any part of the aggregate national capacity to save, nor transfers money into the hands of persons who are likely to save less of it than are the taxpayers from whom it is taken.

127. The case is much clearer in regard to taxation for debt repayment. *We are of opinion that such taxation definitely increases aggregate saving.* It has been put to us by witnesses—and we see no reason to doubt the truth of the contention—that practically the whole of the money received by debt holders as repayments will be regarded by them as capital and re-invested. On the other hand, it is virtually certain that the taxpayers who provide the money for these repayments do so by restricting not only their savings but also their consumption. Practically the whole of the money is saved by the recipients, whereas part, at least, would have been spent had it remained with its original owners. The transfer is thus definitely favourable to saving. We regard this aspect of taxation for debt redemption as of considerable importance, and we doubt whether sufficient attention is generally given to it. We recur below (*paras.* 242 *to* 244) to its implications.

128. There remains some £244,211,000 of direct taxation which is spent upon the external debt, the Civil Services and the Defence Forces, &c. Undoubtedly a part of this money is expended for the benefit of persons whose incomes are not large enough to permit of their making any great savings. This is true, for example, of part of the outlay of the Ministries of Education, of Labour and of Pensions.

129. To take an extreme case, it is evident that practically none of the money spent on Old Age Pensions, or State contributions to the Unemployment Insurance and Health Insurance Funds is invested by the recipients. In so far as these services are financed from direct taxation, we do not think that it can be denied that the direct effect of this taxation is to reduce the total of individual saving; though, even in this case, if any of these services contribute so much to the well-being of the workers as to increase their productive powers, the indirect effects of such taxation may be favourable both to output and to saving.

130. These, however, are extreme cases and they do not represent more than a small part of the total cost of the Civil Services and defences. As regards the whole of these services we do not think that it is possible to say more than that in all probability the ultimate beneficiaries save a somewhat smaller proportion of the money raised for these services than would have been

accumulated by the direct taxpayer had the money been left with him. Such taxation, therefore, is likely somewhat to reduce the total volume of saving.

131. *Looking at both sides of the account, and attempting to estimate the quantitative importance of these figures, we are unable to see any cause for the belief that direct taxation as at present imposed, and as at present spent, can seriously reduce aggregate savings.* The funds raised by such taxation flow in two main directions; first, to meet the cost of the debt service, and, second, to meet the general expenses of Government. The first stream is likely to be, on the whole, favourable to saving; the second is, in part, unfavourable. The first stream exceeds the second by some £60 millions, a figure which represents approximately 1·6 per cent. of the total national income and 2·6 per cent. of the total income in the hands of Income Tax payers. We do not see cause to infer from these figures alone, or in the absence of other evidence, that existing direct taxation has, on balance, effects seriously detrimental to saving.

132. We have so far confined this argument to consideration of the effects of direct taxation, since it is the injurious effect of existing direct taxes that has been most strongly urged upon us. The effects of taxation on saving ought, however, rather to be considered as a whole. No witnesses have suggested to us that the indirect taxes are to any serious extent drawn from savings, since the bulk of them is paid by the poorer classes whose contribution to aggregate savings must in any case be small; while such part as is paid by the relatively well-to-do does not represent a large enough proportion of the incomes of this class materially to affect their capacity to save. Hence the collection of such indirect taxes as are required to meet the cost of the National Debt services is likely to cause a definite increase of saving greater than results from the collection of direct taxes for the same purpose; while, further, there is no corresponding loss of saving on indirect taxes that are used for the ordinary expenses of Government. Existing taxation as a whole is, therefore, more favourable to aggregate capacity to save than is existing direct taxation alone.

133. *Our conclusion is, then, that existing direct taxation distributed over existing Government expenditure is not seriously prejudicial to our aggregate capacity to save, and that existing taxation as a whole is even less so. We do not think, therefore, that there is justification for the view that an important cause of the present unemployment or slackness of trade is a shortage of capital for which taxation is responsible.* It is indeed the opinion of witnesses eminently well qualified to speak on this subject that the real value of our annual new savings is less now than before the War. Mr. Coates estimated national savings in 1924 at £500 millions as compared with £350-£400

millions in 1913. He added, however, that " there seems little doubt that the existing capital equipment of industry is sufficient to maintain a marked expansion of activity without additional capital requirements except in the form of working capital," and that he was " not disposed to think that the existing rate of income taxation has a harmful effect upon the supply of permanent capital " (*Ev. p.* 640; *E. in C.*, 19-25). In any case we think that the considerations which we have mentioned show that the principal causes of a decline in new savings must be sought in factors other than taxation.

Direct Taxation and Enterprise.

134. We come now to the last of the five principal grounds on which existing taxation is held to be injurious to national prosperity—viz., that it discourages enterprise and initiative. " All business enterprise involves risks of greater or less degree. But while the profits of any enterprise are reduced by the amount of direct taxation, 100 per cent. of the risk always remains to be borne by those engaged in it." (*Brand, E. in C.*, 2.) In illustration of this argument, our attention has been called to the fact that in the past few years gilt-edged securities have formed a larger, and industrials a smaller, proportion of the new issues offered for subscription upon the London market. Thus in the three years 1911-13, Government and municipal securities represented 23·3 per cent., 21·0 per cent., and 38·3 per cent. respectively of the total of new issues on the London market, while industrials accounted for 76·7 per cent., 79·0 per cent. and 61·7 per cent. of the total. In 1924 the proportions were Government and municipal 58·9 per cent. and industrials 41·1 per cent.

135. We are of opinion that it is a mistake to ascribe any large responsibility for a decline in enterprise to existing taxation as such. Some part of such decline may indeed be traced to the effect of existing methods of expenditure of the proceeds of taxation, in so far as money spent on the debt services goes, as we have already pointed out, into the pockets of persons who may be presumed, in general, to have a preference for gilt-edged over more risky investments. This redistribution of income in a manner unfavourable to industrial investment is incidental to payments of debt interest, and (unlike the effects of taxation for the debt services upon the quantity, as distinct from the " quality," of saving), it results also from the process of debt repayment. This, however, is quite distinct from the argument, which has been put before us, that existing direct taxation as such (i.e., apart from its expenditure upon the debt service) tends to encourage the taxpayer to abandon risky undertakings in favour of the security of a gilt-edged investment.

136. Those who take this view appear to us to take account of one aspect only of taxation to the exclusion of others. It is generally accepted that investment in risky enterprises yields on the average, over a period, a higher return than does investment in gilt-edged securities. Individuals make their choice between different uses for their capital according as they do or do not feel that the probable return obtainable compensates for the degree of risk which any particular investment entails. Anything which alters either the *relative* return obtainable from an industrial investment, or the *relative* degree of risk attaching to these alternatives, will influence the proportions in which capital is distributed between them. Thus any change in political or economic conditions which adds markedly to the risks of industrial enterprise, without at the same time increasing the profits with which enterprise may expect to be rewarded, will discourage investment in industry, and to that extent create a preference for gilt-edged securities. Again, a special tax on fixed interest stocks would increase the attractiveness of, and attract capital towards, industrial investments.

137. On the other hand, any cause which affects alike the return obtainable from all investments—from Government stocks to the most hazardous industrial enterprise—cannot, so far as we can see, involve any special discrimination against risk-taking such as would divert capital from risky into gilt-edged stocks. Witnesses who have argued that existing taxation penalises enterprise have not, we think, taken sufficient account of the alternatives open to the owner of capital who is supposedly deterred from enterprise by existing taxation. In practice the alternative to industrial investment, the yield of which is reduced by taxation, is investment in some form of bond, the yield of which is also reduced by taxation; and unless taxation reduces the yield of the former *out of proportion* to the reduction it effects in the yield of the latter, it is difficult to see how it can affect an individual's choice between the two.

138. Cases in which such a disproportionate reduction of the yield of speculative investments occurs do not appear to us to be of sufficient importance, or (what is no less material) likely to be sufficiently often anticipated by persons who have capital at their disposal, to have a serious effect upon industry generally. Where no actual losses are made, such cases will occur only in so far as investment in a more speculative enterprise, yielding a higher average rate of return per cent. on capital, may bring its owner within the scope of higher rates of Income and Super-tax than those to which he would be liable if he had invested his capital in a gilt-edged stock giving a lower gross yield per cent. But differences actually resulting in this way in the case of persons who are making investments out of income will be negligible, since, even if a man saves a large part of his income, the additional income resulting from this new capital must

necessarily be very small in relation to his total income.* The remaining cases in which taxation will reduce the yield of risky enterprises in proportion to that of gilt-edged securities are those of the owners of private businesses where actual losses are made which are not offset for Income Tax purposes against the profits of subsequent years. In view of the limited part played by all private businesses in modern industry (*see para.* 225), we do not think that these cases occur, or are anticipated, sufficiently often to be responsible for any serious effect upon industry as a whole.

139. We do not dispute the fact that owners of capital do show a greater preference for gilt-edged investments, and a greater reluctance to embark on large enterprises involving great risks, than has been the case at periods in the past. *But our conclusion is that, since taxation falls alike upon the incomes from all types of enterprise or investment, it cannot be the cause of this preference.* We think that the cause is to be found partly in a change in the distribution of the *ownership* of capital, which we have indicated as one of the objectionable results of the existence of the National Debt, and partly in the increasing risks of industry to the private owner resulting from the greater uncertainty of political conditions and the violent fluctuations of prices, which are legacies of the War, as well as in the growing measure of State control over the public interests involved in industry. Such factors tend to increase the risks of industry, without proportionately increasing its profits; and since they either do not affect gilt-edged securities at all, or are much less important in this sphere, they tend to increase the *relative* attractiveness of this form of investment.

Conclusions as to Direct Taxation.

140. We thus conclude that each of the five arguments which appear to be principally responsible for the fear that existing direct taxation is prejudicial to employment and prosperity rests upon a misconception. *Such taxation cannot, in our judgment, reduce the aggregate purchasing power of the community; nor do we find that it raises prices, or materially reduces the national output of work, of saving, or of enterprise.*

* Adjustments of taxation can only make the net return from investments in industrial enterprises (other than private businesses showing a clear loss on a year's trading) compare more favourably with that obtainable in gilt-edged securities than it does at present where three conditions are fulfilled. First, the investments must be considerable in themselves; second, the investments must be very large in proportion to the income of the investor; and third, the adjustments of taxation must be such as not merely to lessen the amount of the existing charge, but also markedly to reduce the progressive character of the tax scale.

PART III.

METHODS OF DEBT REDUCTION: SINKING FUNDS AND CONVERSIONS.

The Sinking Funds.

141. Under the Finance Act of 1923 a sum of £40,000,000 in the year 1923-24, rising to £45 millions in 1924-25, and £50 millions annually thereafter, was allocated as the "New Sinking Fund" to be applied in redemption of the National Debt until Parliament should otherwise determine. In accordance with this arrangement, which superseded the pre-war New Sinking Fund of variable amount (£5¼ millions in 1913-14), £50 millions for the New Sinking Fund now appears annually upon the expenditure side of the Budget Statement. The Old Sinking Fund, under which any actual surplus of revenue over expenditure realised in any financial year is automatically applied to redemption of debt, still continues.

142. *These Sinking Funds represent the only definite provision now made for redemption of a deadweight National Debt of £7,616 millions.* Repayments under the Old Sinking Fund are of course entirely a matter of chance, and have in fact varied very greatly from year to year. Indeed, since it is the object of the Chancellor of the Exchequer to budget as accurately as possible, efforts are made to avoid large budget surpluses almost as much as deficits, and therefore, indirectly, to reduce to a minimum repayments of debt by this means. During the years immediately following the War, when prices and indeed economic conditions generally were exceedingly unstable, repayments of debt by this means were considerable, e.g., in 1922-23, £101 millions were thus applied, while in 1923-24 the figure was £48,000,000. During the year 1924-25, however, the surplus realised was only £3,600,000, while 1925-26 has ended with a deficit of £14,000,000, neutralising to that extent the effect of previous repayments of debt under the Old Sinking Fund.

143. The New Sinking Fund, on which alone it is possible to count with any degree of certainty, is non-cumulative, i.e. the charge remains fixed at £50 millions and is not increased by the amount of interest saved by repayments of debt. The Fund will thus require a period of 153 years in which to redeem the whole debt.

144. In the Table annexed to Part I of this Report, mention was made of the fact that certain loans carry specific Sinking Funds, i.e. that provision was made in the terms of their issue for the establishment of some kind of fund for their redemption.

For example, under the terms of issue of 3½ per cent. Conversion Loan, the Treasury is required to issue for purchase of debt for cancellation a sum equal to not less than 1 per cent. of the total amount of the loan outstanding at the close of each half-year in which its average daily price has been less than 90. In addition, specific arrangements for redemption (or support of the market price) are attached to the following issues :—

(i) 4 per cent. Victory Bonds and 4 per cent. Funding Loan.

(ii) Life Annuities and Terminable Annuities charged on the Consolidated Fund.

(iii) The debt to the United States Government.

(iv) 5 per cent. War Loan and 4 per cent. (tax-compounded) War Loan.

Sums have also to be set aside to meet the provisions whereby certain Government securities, notably Victory Bonds, are accepted at par or above their market value in payment of death duties.

145. The primary object of these specific Sinking Funds is not so much to expedite repayment of the National Debt as to maintain, by Government purchases, the price of the various loans. Certain of the funds are indeed termed depreciation funds, and are in fact only applicable when the price of the issue to which they relate falls below a certain minimum. By these precautions against any severe fall in the market price of the debt it is hoped both to maintain our national credit in the eyes of the world, and to facilitate the conversion of the debt, as occasion offers, to lower rates of interest.

146. *We doubt if it is clearly understood that the sums necessary to meet these specific sinking funds are included in the New Sinking Fund total of £50 millions.* The establishment of this fund did not, therefore, mark the allocation of a clear addition of £50 millions to the obligations to redeem debt already binding on the Government. Indeed, as the following table shows, much the greater part of the New Sinking Fund is at present required to meet this obligation, the free balance amounting only to £9,991,000 in 1925-26.

	£
Capital of Terminable Annuities	1,085,000
Funding Loan Sinking Fund	2,642,000
Victory Bonds Sinking Fund	2,231,000
Conversion Loan Sinking Fund	14,386,000
Issues to National Debt Commissioners for Bonds, &c., for Death Duties under s. 3 of War Loan Act, 1919	6,995,000
Repayment of War Loan, &c., surrendered for duties under s. 34 of Finance Act, 1917	178,000

United States Government — Repayment under Funding Agreement	4,953,000
Depreciation Fund under the Finance Act, 1917	7,539,000
Balance of New Sinking Fund, 1923, issued to National Debt Commissioners to redeem debt	9,991,000
	£50,000,000

147. The question whether any given Sinking Fund is or is not adequate must always be a matter of opinion, determined by the particular importance attached to the effects believed to follow from the existence of a National Debt on the present scale. We have found that the present non-cumulative Sinking Fund of £50 millions per annum commended itself to a considerable number of our witnesses. On the other hand, we were unable to ascertain any reasoned basis for this figure, other than the fact that it had actually been adopted and commanded the measure of assent usually given to the established order of things in preference to any change.

148. Some witnesses, on the other hand, took the view that the existing provision for repayment of debt was inadequate; Professor Cannan, for example, suggested that a serious effort ought to be made to get rid of the debt in the next 35 years and suggested to that end a cumulative Sinking Fund of £100 millions per annum. We do not think that it has been anywhere suggested to us that the present figure should be reduced, though certain witnesses, notably Mr. Keynes, indicated that, quite apart from the taxation which it involves, a large Sinking Fund might have injurious consequences upon the distribution of capital.

149. We have already indicated the very serious view which we take of the effects of a National Debt on the present scale. It follows that we regard repayment of the debt and reduction of the burden of the debt-charge as matters of great urgency. *We cannot agree that a Sinking Fund calculated to spread repayment over a period of* 150 *years is at all adequate*—least of all when it is borne in mind that practically the whole debt has arisen in consequence of events occurring during this generation; and that, under the present Sinking Fund arrangements, which extend over five generations, our great-great-great-grandchildren would still be paying, at best for the misfortune, and at worst for the crimes, of to-day. We are concerned, therefore, carefully to examine such alternative methods of expediting the process of debt repayment as have been suggested to us in evidence or have occurred to us in the course of our enquiry.

Reduction of the Debt Burden by Conversion.

150. In general those witnesses appearing before the Committee who were opposed to any material increase in the present Sinking Fund were disposed to rely upon successful conversions to effect any further reduction in the burden of the debt, many of them attaching considerable importance to such conversions, though we did not have submitted to us in evidence actual estimates of the savings likely to be realised.

151. The term conversion covers operations of more than one kind. It may be used to describe options of transfer from one to another issue on terms definitely favourable to the investor and unfavourable to the State, such as it was necessary to give during the War when the conditions under which loans were raised were becoming increasingly difficult. But in the present connection the term implies some kind of option—either renewal of an old loan on fresh terms or exchange into another issue—in which the balance of advantage is on the side of the State.

152. Again, conversion options may be offered to the holders of an existing issue at any time during its currency, such holders having of course the alternative of continuing under the original terms of the issue of their loan, if the terms of the conversion are not sufficiently attractive; or a conversion may be effected when a loan matures, holders having the option of conversion or repayment. In the case of loans repayable at any date, such conversions can, of course, be effected at any time when conditions are favourable.*

153. In the case of voluntary conversions during the currency of a loan, it is clearly necessary to offer terms considerably more attractive to the holder than in the case of compulsory conversion upon maturity, when the holder's only alternative is repayment, and there is no option of continuing under the old terms. One method of making the terms of such an option sufficiently attractive is to offer, in exchange for a somewhat lower annual rate of interest, an increase in the investor's nominal holding or a premium at the date of repayment.

154. Recent conversions have been very largely of this type. Thus from the 1st January, 1920, to 31st March, 1925, conversions effected resulted in an increase of £284 millions in the principal of the debt and a saving of £1,191,000 in the annual interest charge. While we do not say that such methods are never permissible, we are in general opposed to them, and we

* We think it may be worth pointing out further that conversion differs from the policy of compulsorily reducing the rate of interest on the debt, in that under any conversion scheme the debt holder has always the option either of accepting the new security offered (or, in cases of conversion before maturity, of continuing his loan on the same terms as before) or of accepting repayment on the terms and at the date prescribed in the original terms of issue of the loan. Conversion does not, therefore, as would an all-round reduction of interest on the debt, involve a breach of the original contract under which the loans to be converted were issued.

think that their application should at all times be very carefully watched, since they offer an easy way of lightening the immediate burden of the debt at the expense of the future.

155. Moreover, as pointed out to us by Professor Cannan, any reduction in the interest charge which is purchased by an increase in the capital of the debt is particularly dangerous, since it tends to minimise the apparent necessity for debt redemption. When the interest charge is comparatively light, no matter what the total capital of the debt, the urgency for the need for repayment will almost certainly be underestimated. If the counterbalancing disadvantages are weighed against the immediate saving on the interest charge, we think that it is very doubtful whether any appreciable relief can be derived from voluntary conversions before maturity, since in such cases the investor is necessarily in a strong position to resist changes that are unfavourable to him.

156. It is rather to the conversion of loans as they mature that attention must be directed, if it is hoped to effect any appreciable saving in the interest charge. The volume of unfunded debt other than Floating Debt, Victory Bonds and Funding Loan, maturing up to 1947-48, i.e. in the next 22 years, and open for conversion, amounts to about £3,600 millions, the interest charge on which is £177 millions per annum. *The gross saving by conversion of the whole of this amount to a 4½ per cent. basis would be somewhat over £15 millions, while conversion to a 4 per cent. basis would give a gross saving of about £33 millions.* The great bulk of the saving, however, would not arise, under conversion at maturity, until towards the end of this period of nearly a quarter of a century.*

157. If the loans in question are divided into three groups according as they mature in or before 1928-9, in the years 1929-30 to 1933-4, and in the years 1942-3† to 1947-8, it will be found that the gross saving from conversion to 4½ per cent. and 4 per cent. bases respectively is distributed as under.

	Up to 1928-9	1929-30 to 1933-4	1942-3 to 1947-8
	£	£	£
Gross saving on 4½% basis	3,450,000	1,114,000	10,545,000
Gross saving on 4% basis	7,839,000	3,053,000	22,207,000

It will be seen that by far the greater part of the possible saving does not arise until the third period; that is, until from 16 to 22 years hence.

* In a few cases conversion upwards would be necessary on these rates of interest; these are allowed for in the savings shown.

† There are no maturities of internal debt between 1933-4 and 1942-3.

158. Several of the loans covered by the above table have, however, alternative dates of repayment, *i.e.*, the Government has an option of repayment before the final maturity. If conversion be effected at these earlier dates, the bulk of the savings shown in the above table as occurring in the third period may be transferred to the second, though there is practically no change in the distribution between the first and second periods. *On this more favourable assumption, therefore, the greater part of gross saving shown by the above table might be realised in eight years.*

159. From these gross savings must, however, be deducted the tax revenue now obtained by way of Income Tax and Super-tax on the interest which disappears as a result of conversion. Such loss of revenue is an inevitable accompaniment of any reduction, by whatever means, in the interest charge on the debt. We deal more fully with its exact importance in our discussion of the Capital Levy, in which connection public attention has been more generally directed to it than has been the case in regard to other methods of reduction of the debt-charge. Our statements here should, therefore, be read in the light of that part of our Report (*paras.* 172-30 and Annexe to Part IV).

160. On a gross saving of £15,109,000 the loss in tax, if we assume a rate of 4*s.* in the £, would amount to £3,022,000, reducing the actual net saving by conversion to a 4½ per cent. basis to £12,087,000. Similarly, on a gross saving of £33,099,000, the loss would amount to £6,620,000, reducing the net saving on a 4 per cent. basis to £26,479,000. We have no means of computing the actual loss of revenue from Income Tax and Super-tax together, but at the present rates it must be considerably higher than the figures that we have given.

161. In the light of these figures, and of the following further considerations to which in our view great importance is to be attached, *we do not feel that the prospect of saving by conversion of debt is sufficiently prompt, sufficiently large, and sufficiently certain to justify reliance on this policy as the only relief additional to the present Sinking Funds.*

162. In the first place, any saving from conversion depends upon an exceedingly dubious assumption, viz. : the prospect of a fall in the general rate of interest. Unless interest rates are falling it will be idle to ask debt holders to convert their holdings to lower rates. They will prefer to claim repayment and seek more remunerative investments elsewhere.

163. We have absolutely no means of forecasting the future course of interest rates; nor do we think that history throws much light on what may be expected in the quite different conditions of the future. We might hazard the forecast that, should there be any marked revival of trade, interest rates might be more likely to rise than to fall. But as regards the level and the movements of interest 10, 20 or 30 years hence, we do not think that the materials for any reasoned opinion exist, and we cannot,

therefore, commit ourselves to the assumption, implicit in the arguments of many of those who expect material relief from conversions, that a fall in interest rates over the next quarter or half century can be counted upon. We can find neither more nor less evidence in support of this than in support of an exactly opposite assumption.

164. Second, even if interest rates do fall, there must, we suppose, be a not very distant limit to their fall. They are not high enough to fall very far. There is, therefore, no prospect of *continued* savings from conversion of any appreciable size. Each saving actually effected necessarily reduces the prospect of further conversion thereafter.

165. We conclude, therefore, that substantial relief from the burden of the debt cannot be relied upon with certainty from a policy of conversion. At the same time, we do not, of course, wish to overlook the possibility of making some savings by this means, and we hope that advantage will be taken of every opportunity for conversion on terms that (having regard both to immediate and to future effects) are favourable to the State. Indeed we think it a not unimportant subsidiary advantage of the measures which we propose below for more rapid repayment of debt that, by maintaining the price and reducing the yield of Government stocks, these may themselves improve the chances for further conversions. We feel bound to point out, however, that the savings from conversion are necessarily limited in amount, offer no prospect of *immediate* relief, and are wholly contingent upon an assumption for which we have not been able to find any evidence.

PART IV.

THE CAPITAL LEVY.

Nature of Levy Scheme.

166. The most comprehensive scheme which we have had to consider for reducing the National Debt by a substantial amount within a short period is the proposal for a Capital Levy which was submitted to us in evidence by the Trades Union Congress, the Co-operative Congress, Mr. Pethick-Lawrence and Dr. Hugh Dalton, and on a smaller scale also by Professor Macgregor. The Trades Union Congress and the Co-operative Congress had in mind a levy calculated to yield about £3,000 millions; Dr. Dalton a levy yielding not less than £2,000 millions, and preferably nearer £4,000 millions; Mr. Pethick-Lawrence hoped for a yield of 3½ to 4 milliards; while Professor Macgregor thought that the best results would be obtained from a levy of £1,000 millions.

167. In what follows we propose to address our remarks, except where otherwise stated, to consideration of a levy of the type proposed to us in evidence by the Trades Union Congress. This proposal conforms closely to the scheme put forward by the Labour Party in their pamphlet (1922) *Labour and the War Debt*, and has had more general consideration throughout the country than has any other scheme. We have, however, also had in mind the claims of alternative proposals, and, where these differ materially from those of the Trades Union Congress scheme, we indicate below our views upon them.

168. Under the Trades Union Congress scheme it was proposed to raise a levy upon a graduated scale from all personal owners of capital in excess of £5,000, companies and corporate bodies being, as such, exempt. The scale was to be so adjusted as to raise a gross sum of £3,000 millions, and the whole of the proceeds applied to redemption of debt. A provisional scale of graduation was published in *Labour and the War Debt*, and ranged from a charge of 5 per cent. on the excess over £5,000 of an owner of not more than £6,000, to a charge of 60 per cent. on the excess over £1,000,000 of every owner worth more than that amount.* The witnesses on behalf of the Trades

* The scale is as follows:—

					Levy. per cent.
First	£5,000	£0	—	£5,000	0
Next	£1,000	£5,000	—	£6,000	5
,,	£2,000	£6,000	—	£8,000	10
,,	£2,000	£8,000	—	£10,000	15
,,	£5,000	£10,000	—	£15,000	20
,,	£5,000	£15,000	—	£20,000	25
,,	£10,000	£20,000	—	£30 000	30
,,	£20,000	£30,000	—	£50,000	35
,,	£50,000	£50.000	—	£100,000	40
,,	£100,000	£100,000	—	£200,000	45
,,	£300,000	£200,000	—	£500,000	50
,,	£500,000	£500,000	—	£1,000,000	55
Remainder		Above £1,000,000			60

Union Congress, while referring to this scale, expressed the view that more importance was, in their judgment, to be attached to the total sum to be raised than to the detailed graduation shown in the scale.

169. The Board of Inland Revenue prepared for the Committee an estimate of the yield of a levy upon this scale. This shows that at the present date such a scale would be unlikely to raise more than £2,500 millions. In accordance, therefore, with the views expressed by the principal witnesses who advocated a Capital Levy—namely, that the scale should, if necessary, be adapted to fit the total sum to be raised and not *vice versa*—we have had in mind a levy of £3,000 millions, and have assumed that, if such were imposed to-day, it would be on a scale of 20 per cent. greater severity than that put forward in *Labour and the War Debt.*

THE CASE FOR THE CAPITAL LEVY.

(i) *Reduction of Debt.*

170. The primary advantage claimed for the Capital Levy by its advocates is that it is the only scheme which has yet found any considerable measure of approval that proposes to effect repayment of the National Debt on any large scale in the immediate future. The first merit of the Capital Levy in their judgment is simply that it will reduce the National Debt. The proposal is, therefore, necessarily associated with certain views as to the gravity of the injurious effects due to the debt. If the debt itself has no serious consequences, there can be no object in proposing a Capital Levy to repay it.

171. We have already indicated in the first part of our Report the serious view which we ourselves take of the effects of the debt on the majority of the working citizens of this country. If we do not reiterate here the advantages claimed for the Capital Levy purely as a means of debt repayment, it is because these are simply the obverse of those disadvantages attaching to the National Debt which we have discussed above. Since, however, we have associated ourselves with opinions regarding the National Debt generally held by the advocates of a Capital Levy, we are bound to give very careful consideration to their proposal for debt redemption; and in event of this proving unacceptable, ourselves to seek for some alternative.

(ii) *The Net Annual Saving on the Budget.*

172. In the second place, attention is drawn by advocates of the Capital Levy to the " net annual saving " on the Budget which must necessarily follow from repayment of debt on any large scale. By repayment of debt a certain gross saving is effected on expenditure upon debt interest. Assuming, as have

the Board of Inland Revenue in their estimate, that debt is redeemed on a 5 per cent. basis, this gives a gross saving of £150 millions per annum from a Capital Levy of £3,000 millions.

173. Since, however, Income and Super-tax are charged upon the interest, and death duties upon the capital, of the debt, it follows that any repayment or conversion of the debt necessarily reduces the yield of some or all of these taxes. When debt is cancelled, the cost of interest upon it disappears from one side, and the revenue from taxation upon that interest from the other side of the national accounts. If both sides of the accounts are taken into consideration, the *net* annual saving consequent upon a Capital Levy must be materially less than the *gross* saving in interest alone. So long, however, as taxation on the interest and capital of the debt amounts to less than 20*s*. in the £, the whole of the gross saving by reduction of the interest charge cannot be cancelled by loss of taxation upon that interest; some net saving must result.*

174. The exact amount of this net saving from any given Capital Levy is necessarily very difficult to determine. Widely varying estimates have been put forward at different times by various writers on the subject of the Capital Levy: and, indeed, since the loss of revenue from taxation on debt interest itself depends upon the rates of taxation prevailing at any time, it follows that, quite apart from the difficulty of estimating correctly, the results of accurate calculation must necessarily differ at different times. Witnesses who supported the Capital Levy before us were generally disposed to agree that only official estimates could be relied upon in this connection.

175. The Board of Inland Revenue also furnished the Committee with an estimate of the net annual saving from a Capital Levy with Income and Super-tax and death duties at the rates in force for 1925-26. *On this basis the Board calculate that a levy on the provisional scale shown in "Labour and the War Debt," yielding £2,500 millions, would give a net annual saving of £48 millions. A levy of £3,000 millions, obtained by increasing this scale by 20 per cent. throughout, would give a net saving of nearly £58 millions.*

176. Supporters of the Capital Levy claim as one of its principal advantages the release of this net annual saving, to be applied either in relief of taxation or to fresh expenditure which it is not otherwise possible to incur. Stress was particularly laid upon the claims of increased social expenditure, and upon the reduction of such taxation as is borne by the poorer sections of the community. Of the merits of the former it is outside our province to judge; of the desirability of the latter we have already expressed our approval (*paras.* 67 *to* 75).

* Another aspect of this difference between the gross and net annual saving from a levy, which appears to us of some importance, is discussed in the Annexe to Part IV. of our Report.

177. In comparing the net annual saving achieved by a Capital Levy with alternative methods of raising the same sum of money, advocates of the levy claim certain further advantages for their method. A sum of about £58 millions per annum might be raised to-day by increasing the standard rate of Income Tax by 1*s.* in the £. This revenue, however, is contingent upon the continuance of such increased taxation. The annual saving consequent upon a Capital Levy once carried through, remains assured in perpetuity; whereas, if it is proposed to raise a similar amount by fresh taxation, it will always be open for Parliament to undo in one year what it did in another, and experience suggests that the temptation to do this is likely to be considerable. In short, the one method is permanent and certain, the other temporary and uncertain.

(iii) *Equitable Case for a Capital Levy.*

178. We proceed to consider certain arguments in equity which appear to have played a very large part in gaining popular support for the Capital Levy.

179. The Capital Levy is represented by its advocates as imposing the burden of war expenditure upon the shoulders best fitted to bear it. The argument runs as follows. The War was financed by methods involving very heavy burdens upon the post-war period, which somebody must carry. Those who have capital in excess of £5,000 have, whatever their personal or family circumstances, security against economic distress involving serious physical hardship. They are a minority, and, whether this is the result of their own efforts or of those of other people, they are in fact in a position of economic well-being which is never attained by the vast majority of our citizens. If there is heavy taxation to be borne, it is this minority alone who are in a position to bear it without disproportionate hardship.

180. The income derivable from a capital of £5,000, assuming only the low yield of 4½ per cent., amounts to £225 per annum, which is in excess of any income now ordinarily earned by the wage-earning population who constitute the great majority of the population. Further, since the income of an owner of capital is not dependent, as is that of a worker, upon the life and health of the recipient, the owner of an investment income of, say, £225 per annum, is in a stronger position to pay exceptional taxation than is one whose annual earnings reach that amount.

181. The force attached to these considerations necessarily depends on the general view taken of the objects of taxation for any purpose. The direct effect of a graduated Capital Levy is obviously to mitigate somewhat the existing inequality in the distribution of wealth. In accordance with the views already expressed (*para.* 30), we should necessarily consider this an important incidental advantage of a levy which would have

material weight in forming a decision as to the balance of advantage for or against a levy; though we do not suggest that the effect on the distribution of wealth of such a levy as that which has been urged upon us is, by itself, ground for recommending or rejecting a Capital Levy as a means of debt repayment.

182. Certain other equitable considerations may also be advanced in favour of a Capital Levy. Whoever must take the responsibility for the cost of the War and of the means adopted to finance it, that responsibility cannot be laid at the door of the generations to come; and it may, therefore be argued that we of to-day should make every possible effort to shoulder these burdens, and not ask posterity to pay for events over which they can have had no possible control. *So long as there is no Capital Levy, with every year that passes there is a steady increase in the proportion of taxpayers who are meeting the cost of a debt over the creation of which they had no control.*

183. Again, our attention is called to the contrast between the very large profits made during the War by some of those who were exempt from military service, and the risks and hardships incurred by those who served in the Forces. Conscription of life is contrasted with failure to conscript wealth; and it is urged that a strong case exists for exacting a substantial contribution towards the money cost of the War from those who either actually made money out of the national emergency, or at the least, found themselves at its end still in possession of considerable means. This contrast undoubtedly played a great part in the popular demand for a Capital Levy in the years immediately after the War, when indeed the conditions which it supposes were most accurately realised.

184. Finally attention is drawn to the very heavy increase in the real burden of the internal debt consequent upon the severe fall in prices that has occurred since the boom period immediately following the War. We have already, in the first part of our Report, drawn attention to the effects upon the debt of the change in the price level. In connection with the Capital Levy it is urged that the large unearned increment, presented to debt holders as a class by the fall in the price level, illustrates the unfortunate consequence of our not having imposed a Capital Levy immediately after, if not actually before, the War was ended.

The Equitable Case against a Capital Levy.

185. In turning to consider the arguments that are brought in opposition to the Capital Levy, we deal first with considerations of equity; since, if it can be shown that a Capital Levy, even if carried out under the most favourable conditions, is a fundamentally unjust proposition, there is no occasion to discuss the problems inherent in its practical working

186. The principal argument against the equity of a Capital Levy which has been put before us, and that which we think is generally felt by opponents of a levy to have greatest force, is that the levy involves a penalisation of thrift which is both unjust and also economically indefensible. Contrast is drawn between the man with a considerable income who lives up to it, and the man who, by saving, both provides for his own dependants and increases the national capital. Under a Capital Levy the former goes scot free, while the latter must pay.

187. In all novel forms of taxation certain inequities are inevitably felt. We think that it is in cases such as those cited that the Capital Levy is most likely to present itself as unfair; and particularly in the contrast between the recipients of large earned incomes which escape, and of more moderate investment incomes which have to pay.

188. In assessing the weight to be attached to these considerations we feel bound, however, to take into consideration certain other factors which are often overlooked. In the first place, *thrift is not the only pre-requisite for the acquisition of a fortune exceeding* £5,000. A working man earning the now comparatively good wage of £3 a week, even if he is employed regularly for 50 weeks in the year, does not receive throughout an adult working life of 45 years more than a total sum of £6,750. No amount of thrift can bring him within reach of a Capital Levy having an exemption limit of £5,000. Acquisition by the exercise of thrift of a fortune exceeding £5,000 implies in fact the possession both of that virtue and of the means upon which to exercise it. Although, as we have already indicated (*paras.* 108-133), we are alive to the importance of maintaining the national capital, *we are disposed to think that disproportionate weight is often attributed to the virtue of saving as compared with the importance of securing a wider diffusion of something to save.*

189. In the second place, it is obvious that a very large number of properties owe nothing whatever to the thrift of their present owners. They are the result of inheritances or of one or other of the many forms of unearned increment arising in our industrial system.

190. It is further urged against the equity of a Capital Levy that the supposed contrast between those who fought in the War and those who stayed at home and made money out of it is at any time based on an unjustifiably simple generalisation, and becomes increasingly unreal as we travel further away from the immediate war period. At most, it is felt, this might have been made ground for the special taxation seven or eight years ago of wealth made directly out of the War; it is no reason for a Capital Levy to-day.

191. We think that at any time there is considerable force in this contention and that this force obviously increases with the lapse of time since the War ended.

First Conclusion on the Equity of a Capital Levy.

192. In balancing the conflicting considerations of equity set out above, we are led to the conclusion that a strong case has been established by advocates of a Capital Levy for imposing upon owners of accumulated wealth in a steeply graduated form the taxation incidental to any large effort to repay debt at an early date. Whether or not this taxation should take the form of a Capital Levy must, in our view, depend very largely upon the further considerations which we proceed to discuss below, the force of many of which must be greatly affected by the conditions prevailing at the time when it is proposed to carry a levy into effect.

Practical Considerations in regard to a Capital Levy.

(i) *General Practicability.*

193. The note submitted to the Committee by the Board of Inland Revenue on the practicability of a Capital Levy, while pointing out that a levy is in all conditions a task of the first magnitude, gives no ground for the belief, which we think prevails among a section of the public, that the practical difficulties involved in a Capital Levy are insuperable. In 1919 the Board expressed the view that a levy upon the increase of wealth during the war period was not outside the range of practicability; and this evidence has been quoted by certain of our witnesses in support of the proposal for a Capital Levy.

194. In order to test the validity of this evidence, the Committee asked the Board of Inland Revenue how far, and with what modifications, their conclusions as to the practicability of a levy on War Wealth may be applied to a Capital Levy. In their reply the Board emphasise the high degree in which the success of a levy of either type must be influenced by the attitude adopted by the taxpayers affected, but, assuming a reasonable measure of goodwill, they give no reason for supposing that a Capital Levy is a less practicable proposal than a levy on War Wealth; while "from a technical point of view the assessment of a liability to Capital Levy would normally be less difficult than a corresponding assessment to War Levy."

195. At the same time it has been put to us that there are important practical difficulties which would inevitably arise in the attempt actually to impose a levy, and which are sufficiently serious to make the Capital Levy an undesirable, even if a feasible, method of debt repayment. To some of these difficulties we attach considerable importance; others appear to us to be largely based on a misconception of the nature and purpose of a levy. We proceed to discuss below the significance of such as

appear to have weighed most with witnesses who were opposed to a levy, or to have played the largest part in general discussion of the pros and cons of a Capital Levy.

196. We understand that the practical difficulties of a levy would be much less if it were confined, as we have supposed it would be, to fortunes exceeding £5,000, than if it were extended to smaller properties. Witnesses have suggested to us that, on equitable grounds, a limit of £5,000 is too high, and that its adoption on grounds of practical convenience is indefensible; £1,000 is suggested as a more suitable starting point.

197. We have no hesitation in rejecting this suggestion. Both practical convenience and equity appear to us to point in the same direction. A levy on fortunes of less than £5,000 would mean a great expense on assessment for very little additional return; nor, in our view, are persons possessed of less than this amount generally in a position to bear special taxation. Indeed, even supposing only a return of 4½ per cent., a married couple with a capital of £5,000 are at present exempt even from Income Tax. To impose a Capital Levy on a person having only £1,000 of capital is to demand a special contribution towards the cost of the War from incomes of less than £1 a week. We can see no justification for such a proceeding.

(ii) *Problems of Valuation.*

198. The Capital Levy would necessitate the valuation at a given date of the property of all persons liable or likely to be liable to the levy. We understand from the Board of Inland Revenue that the number of individuals now owning more than £5,000 is in the region of half-a-million. It is submitted that this valuation would involve major problems of two distinct kinds.

199. First, owing to technical difficulties, arising particularly in regard to the valuation of settled property, it would be difficult to give a fair estimate of the value of many owners' total wealth at the appointed day.

200. Second, owing to the rapid changes liable to occur in the case of certain capital values, even an accurate valuation at the appointed day might bear little relation to the actual value of the same property a few months later. In consequence a man assessed at £10,000, and liable to pay on the scale appropriate to that rate, might, even before he had finished payment of his share of the levy, find himself worth only £6,000; another assessed at the same amount might shortly afterwards be worth much more, and thus escape with payment of a sum which, when actually paid, would be substantially less than the scale-rate on the then value of his capital.

201. As to the first of these problems we are satisfied that the difficulties are not insuperable. The Board of Inland Revenue were prepared in 1920 to undertake the much more difficult task of valuation of capital for a levy on the increase of wealth during the War as between two different dates—one six years previous to the date of valuation. They have suggested methods of overcoming the difficulties in regard to the valuation of settled property—particularly life interests—which appear to us to be reasonably satisfactory, and which are in fact found to work efficiently in valuations for death duty purposes. In all assessments to taxation certain inaccuracies and inequities occur in individual cases. We see no reason to suppose that these would be abnormally great in the case of a Capital Levy.

202. The second difficulty appears to us more serious. If a Capital Levy could be imposed during a period of comparative stability of prices the difficulty would indeed be at a minimum. We do not think, however, that it would at any time be negligible, or that it would be possible altogether to rule out appeals (on both sides) against assessments based on valuations which became quickly out of date. Any great multiplication of appeals and re-assessments would, however, obviously much complicate the actual machinery of the levy and reduce its efficiency as a speedy and equitable means of debt repayment.

(iii) *Destruction of Capital.*

203. We think that the fear that a Capital Levy would involve destruction of capital has played no small part in creating opposition to the levy proposal. In one sense this fear seems to us to arise from a misunderstanding. A levy, the proceeds of which are used to repay the National Debt, cannot destroy capital, since the debt represents no real capital whatever, but only an unproductive charge upon the revenues of the country. As the war expenditure from which the debt arose created no capital, so cancellation of the debt, whether by a levy or by any other means, destroys none. At the end of the operation, the real national capital remains the same as before, though the money capital of individuals is diminished by the cancellation of the paper securities of which the debt consists. We point out in the Annexe to this part of our Report how reduction of the interest charge of the debt reduces the apparent money income of the nation without affecting our real income at all; in an exactly similar way debt reduction by a levy reduces the money total of our capital, inflated as it is by the debt, but leaves the real productive assets of the nation entirely unaffected.

204. In a second sense, however, the view that a levy destroys capital may be understood to mean that it destroys the motive to create capital. We have already discussed both the motives which prompt saving (*paras.* 109-122) and the importance to be attached to this operation; and do not propose to cover this

ground again. It has been put to us, on the one hand, that a Capital Levy carried out once only would involve a less serious discouragement to saving than continuous high rates of annual taxation; while, on the other hand, it is argued that a Capital Levy would induce an attitude of cynical despair on the part of those who are in a position to make substantial savings.

205. We find it very difficult to strike a balance between these conflicting considerations. First, the effect of a levy on future savings clearly depends to a considerable extent upon the confidence of levy payers that the Capital Levy is an exceptional operation designed to meet exceptional circumstances and not to be forthwith repeated. It is agreed by all parties that no absolute guarantee against repetition can be given under our Constitution; and, indeed, it would be obviously undesirable even to attempt to bind posterity in all circumstances and for all time.

206. At the same time we do not think that it should be impossible to devise a form of guarantee against repetition of the levy for one or more generations, which would both be observed in fact and command the confidence of the public. The State does in fact engage in contracts which are held binding by successive Governments of differing political complexions. The very terms of issue of the various loans composing the National Debt are conspicuous illustrations of such contracts, binding sometimes for as much as 70 years, the good faith of which is not questioned by investors and has never been tampered with by Governments in this country.

207. We think it is clear that the effect of the levy on savings is a matter which would be in a large degree affected by the circumstances prevailing at the time when a levy might be proposed. The volume of saving depends largely on the psychological state of the very class who would be liable to a levy. Judging from the statements of our witnesses and from the literature on the subject, we think that the attitude of representatives of this class is different now from what it was six years ago. We have no means of judging what it may be six or even three years hence; nor of how far the actions of individuals in regard to their savings correspond to their own generalisations as to the effect of the levy on savings generally.

208. *We can only conclude that the effect of a Capital Levy on savings is a matter which affects not so much the general question whether a levy is or is not desirable, as the moment at which a levy, if deemed expedient on other grounds, may best be introduced, and the circumstances in which it is most likely to be successful.*

(iv) *Flight of Capital.*

209. The fear that a Capital Levy would drive capital from the country has been very generally expressed. This is one

of the objections to a Capital Levy the force of which, we think, has been greatly exaggerated. A levy would be charged upon capital in the ownership of British residents, and could not legally be evaded except by those who were prepared themselves to emigrate along with their capital. The mere transference of wealth into foreign securities would afford no legal means of escape, since these, if the property of resident British owners, would be no less liable to the levy than investments in this country.

210. We doubt if this point has been sufficiently realised. Similar fears have often been expressed in regard to proposed increases of normal taxation. Though we have made no detailed investigation upon this point, we think that, had emigration to avoid taxation been taking place on any serious scale, we could not but have found evidence of the fact in the course of our enquiries. No such evidence has come to light. Permanently to remove one's domicile to another country is a drastic step only possible to those who have exceptionally few ties of business or family. It may often be threatened, but we doubt if it is often actually taken under the inducement of no more urgent or creditable motive than a desire to evade taxation. In the case of a Capital Levy, we are particularly sceptical as to the likelihood of the country being seriously impoverished in this way. It would seem a somewhat quixotic action for anyone to effect a permanent change in his whole place and mode of living in order to escape payment of a single non-recurring tax even of a drastic character.

211. Attempts may of course be made to escape a Capital Levy or any other form of taxation by fraudulent means. We think, however, that the information as to the wealth of individuals already acquired for Income and Super-tax purposes by the Board of Inland Revenue must be sufficiently detailed to serve as a check on any serious loss from this cause; nor, indeed, do we think, or understand the opponents of a levy to suggest, that it is by evasion of this kind that a levy would be defeated.

(v) *The Effect of a Levy on the Prices of Securities.*

212. We have next to consider the risk that a Capital Levy would lead to heavy sales of Stock Exchange securities on the part of holders wishing to realise the means of paying their levy.

213. We can see no ground for anticipating any general fall in security prices as a result of a levy—unless indeed such should be engineered with the express purpose of discrediting the whole scheme. For, in the first place, there is no reason to suppose that any large part of the levy need be paid in cash at all. The Board of Inland Revenue estimated that, in the case of a levy of £2,500 millions on the scale suggested in

Labour and the War Debt, 50 per cent. might be paid in Government securities. We have no figure for a levy of £3,000 millions, but we do not suppose that the proportion would be very much less.

214. As regards the balance of payment, we think that cash payments and the necessity for realisations could be reduced to a minimum, if the Government were to accept approved securities in payment and to negotiate the direct exchange of these with debt holders whom the levy is to repay—on the lines which were suggested by Mr. (now Lord) Arnold in the *Economic Journal* of June, 1918, and which appear to us practicable.

215. Realisation of securities might thus be virtually confined to those that were not approved for this purpose, such as industrial stocks. We think that a levy might well cause some depreciation in these, and that this fact would render a levy inopportune at a time when there was a marked depression in such securities, and salutary when there was a boom in industrials. Even in this case, however, two mitigating factors must be taken into account.

216. First, since the whole proceeds of the levy are allocated for debt repayment, against owners of capital wishing to realise for the purpose of levy payment must be set an exactly equivalent body of debt holders seeking fresh investments to take the place of their holdings of National Debt now repaid. *Over the whole area of securities there must be buyers to the exact extent that there are sellers.* Though former debt holders, as a class, are likely to give their first preference to gilt-edged securities, any relative appreciation in the gilt-edged market (due to the advantages attaching to securities " approved " for levy payment, and to the pressure of paid-off debt holders for fresh gilt-edged investments) and depreciation of industrials will certainly divert some part of their money and that of other investors to the support of the latter.

217. Second, disturbance in security values consequent upon a levy is necessarily of a temporary character. So far as realisations are necessary, they must be concentrated into a comparatively short period. We think that there is ground for the suggestion made to us in evidence by the Trades Union Congress that depreciation due to factors of such limited duration necessarily carries its own corrective within itself, inasmuch as there would be a speculative demand for securities thus depreciated, in anticipation of their revival as soon as the influence of these temporary factors had passed.

(vi) *Effect of a Levy on Credit and the General Price Level.*

218. We have had conflicting evidence as to the probable effect of a levy upon the issue of bankers' credits and, through this, upon the general price level. On the one hand it has been represented to us that the cancellation of so large a volume of

securities as upwards of £3,000 millions (nominal) of holdings of War debt must necessarily restrict the basis of credit and lead to a serious contraction.

219. On the other hand it has been submitted, first (*e.g.* by Mr. McKenna) that the volume of bankers' advances is determined not by the volume of good securities which borrowers have to offer, but by the funds which the banks themselves have at their disposal. Banks desire to maintain that proportion between their cash resources and their liabilities which maximises profit without endangering safety. If liabilities fall short of this proportion, credits will be increased; if the proportion is exceeded, credits will be diminished, without reference to the aggregate volume of National Debt or other securities in the hands of the public.

220. Second, there is evidence that the volume of securities actually pledged as a basis for credit is only a very small proportion of the total volume available for that purpose. If National Debt were cancelled, other securities could take its place. In this connection it is pointed out that the National Debt has increased since the War in far greater proportion than has the amount of bankers' advances, and that in consequence the greater part of the debt cannot in fact be actually in use as a basis of credits. Reference is made in this connection to the evidence given before the Select Committee on Increase of Wealth (War) by the Board of Inland Revenue.

221. In the third place, it is pointed out that, so long as this country is on a gold standard, our price level is necessarily determined by the world value of gold, and cannot diverge otherwise than temporarily and in a small degree from the level of gold prices throughout the world.

222. In the main we think that there is substance in these last contentions. At the same time we are not prepared to say that the imposition of a Capital Levy, particularly if opposed by the leading bankers, would be unaccompanied by any temporary disturbance of the price level. We are of opinion that the only safeguards against such a disturbance, and consequent effects upon employment, would be a wise choice of the moment of imposition of a Capital Levy, and sympathetic administration on the part of the banks.

223. We think also that, while the cancellation of some £3,000 millions of National Debt securities would not seriously affect the aggregate power of borrowers to obtain credit from the banks, it might materially modify the distribution of that power between individuals. It does not follow that the " second line " securities which are available to take the place of National Debt that is paid off are in the hands of the same individuals as were those holdings of debt. We think that this is one of the drawbacks

incidental to a levy as a means of debt repayment, and, though we do not regard it as sufficient by itself to outweigh the advantages to be derived from large scale repayment of debt, it must not be overlooked in the choice of the best means of attaining that end.

(vii) *Payment of Capital Levy by Private Businesses, etc.*

224. We have already indicated our view that a substantial portion of a levy could be paid either directly in British Government securities or by the exchange of other " approved " stocks. There remain certain cases in which this would not be possible, of which that most frequently cited before us is that of the owner of a private business having sufficient wealth to be liable to make a contribution to the levy greater than could be met out of income, and without appreciable liquid resources outside his business.

225. Advocates of the Capital Levy have generally agreed that in cases such as that named, as also in the case of farmers and landed proprietors having little free wealth, payment of the levy would have to be made by instalments out of income. They have, however, also argued that such cases constitute a very small proportion of the whole, and have quoted in support of this contention the figures given by the Board of Inland Revenue in evidence before the War Wealth Committee in 1920, which showed that, even before the War, of the total national capital (excluding national and municipal property, and capital invested in non-income producing assets), probably not more than 9 per cent. was in the form of capital invested by individuals and partners in industry, trade and commerce.

226. In order to test the validity of this contention, the Committee sought from the Board of Inland Revenue further particulars relating more nearly to the present time. The Board accordingly repeated for the same firms in 1923 an enquiry which they made in 1919 into the position of some 216 manufacturing and trading concerns of a private character, owned by 454 individuals. They find that out of total assets of £27½ millions representing the private and business resources of these individuals, only 48 per cent. or a little over £13 millions were accounted for by business assets.

227. *If these figures are representative, we think it is clear that the proportion of free wealth not " locked up in the business " in the hands of proprietors of private concerns must be much larger than is often supposed, and that the advocates of a Capital Levy are therefore justified in their view that payment by instalments would be necessary only in a minimum number of cases.*

THE LEVY AND UNEMPLOYMENT.

228. We find that the fear that a Capital Levy would cause widespread unemployment has played a great part in the writings and speeches of opponents of a Capital Levy ; though we

think that this aspect of the matter has been more generally stressed in discussion elsewhere than in evidence before us. If this fear were well grounded, it would, in our judgment, be by itself sufficient ground for rejecting the Capital Levy as a means of debt repayment. The chief evil of the debt is the burden which it imposes on the majority of the working population. It would be worse than futile to propose to get rid of this evil by any means which involved consequences which are justly dreaded in the highest degree by that same population.

229. We do not, however, think that there is reasonable ground for this view, and our reasons for this conclusion are implicit in what we have already said as to the effects of a levy upon prices and upon private businesses. The most potent cause of unemployment is a general fall in the price level. We have already given reasons for supposing that no such fall need accompany a levy. Or again, unemployment would be caused by any factor which gravely restricted the resources which employers have for use in their businesses. By far the greater part, however, of our trade and industry is now in the hands of joint stock companies, which would not be liable to or affected by a levy; and, so far as private businesses are concerned, we have already given evidence for supposing that the resources in the hands of proprietors outside their own businesses would normally be more than adequate to cover their levy obligations.

230. At the same time, though a levy *need* not, in our view, be a cause of unemployment, we do not doubt that it *might* have this effect, in consequence of misunderstanding of its purpose, or of panic, or of a mere obstructive desire to discredit the whole attempt. We do not wish to minimise this risk, which in our judgment might be sufficient seriously to jeopardise the proposal.

Conclusions as to a Capital Levy.

231. We are now in a position to state our conclusions in regard to the Capital Levy. *We regard the levy as equitable and, in accordance with the statement of the Board of Inland Revenue, as practicable also, provided that it is accepted with general good-will.*

232. Throughout our discussion of the practical difficulties likely to be encountered in the working of a levy, it has indeed been apparent that these would be at a minimum if the nature of the operation were understood, and its purpose endorsed, not only by the majority of the citizens, but also by the greater part of those liable to the levy, and by the banks and others whose assistance in the financial operations incidental to it would be of material value. In this respect conditions were evidently much more favourable in 1919 and the early part of 1920 than they are to-day. *We have no hesitation in saying that a Capital Levy at that time could have been carried out comparatively easily and that it is a matter for great regret that no levy was*

then imposed. We feel this the more strongly in view of the heavy fall in prices which, as already pointed out, has so materially increased the real burden of the debt since that date.

233. A Capital Levy would still in our judgment be the best method of dealing with the debt, provided that it were generally approved and assured fair treatment by the taxpayers, and were not obstructed by artificial multiplication of appeals, or by deliberate attempts to create panic in the minds of the public. Parliamentary Government indeed always requires the faithful acceptance by all concerned of measures constitutionally carried.

234. In any case, we hope that by the analysis contained in this Report we may ourselves have done something to create the very conditions of understanding and good-will which are requisite for the successful working of a levy in practice. *If these conditions are fulfilled, the nation may yet turn to the Capital Levy as a wise and practicable measure offering the best road out of its difficulties.*

ANNEXE TO PART IV.

Certain Aspects of the Difference between the Gross and Net Saving from a Capital Levy.

We think that attention should also be given to another aspect of the gross and net saving from a levy, which, however, we do not notice to have been considered by witnesses either for or against the Capital Levy. It is generally agreed that payment of interest upon the internal debt, though it increases the total nominal money income of the nation, adds nothing to the real national income out of which, in the last resort, taxation is paid. Similarly, the cancellation of debt interest consequent upon the repayment of debt reduces, it is true, the money yield of taxation at a given rate, e.g., of Income Tax at a standard rate of 4s. in the £. But it reduces also the proportion of the total real national income which is absorbed by taxation at a given rate, and thus lightens the real burden of such taxation.

Thus, we may suppose that the present annual value of our output of goods and services is £3,500 millions per annum, and that of this sum £300 millions per annum is transferred from taxpayer to debt holder by way of interest, giving a total nominal money income liable to taxation of £3,800 millions per annum. An Income Tax at, say, an average rate of 2s. in the £ over the whole of this taxable income would yield £380 millions per annum, and would absorb 10·9 per cent. of the total national real income. If the whole debt were repaid, and £300 millions per annum thus written off the total taxable money income, Income Tax at 2s. would, it is true, give a money yield of only £350 millions per annum; but this rate would absorb only 10 per cent. instead of, as formerly, 10·9 per cent. of the total national real income. *After* repayment of debt an

Income Tax of just under 2s. 3d., yielding £380 millions, could be imposed without any increase in the proportion of the total national income taken in taxation.

We think that this point has escaped notice in the discussion of a Capital Levy on both sides, and that it is not unimportant. The individual taxpayer thinks of the burden of taxation upon himself chiefly as a matter of the rate charged upon his income or capital. He pays so much in the £, and is better or worse off according as this rate is diminished or increased. But in so far as it is reasonable to speak of taxation as a "burden" on the nation as a whole, in measuring this burden the effect of raising a given sum in taxation must necessarily be related to the amount of the total real national income. After a Capital Levy the *rates* of taxation necessary to raise a given sum, say, £50 millions, must be higher than before; but expenditure of £50 millions absorbs exactly the same proportion of the total national income as formerly.

It follows that, if our capacity for public expenditure is ultimately limited, as has been suggested, by the total national income, it is unaffected by the loss of money revenue from certain taxes consequent upon a Capital Levy. Indeed, were it reasonable to argue that our capacity for expenditure is *reduced* by reduction of the National Debt, it would be no less reasonable to argue that this capacity would be increased by an increase in the National Debt, and that the debt is positively advantageous, in so far as it increases the total money taxable income—an obvious paradox. In the example given above, if debt interest had required £500 millions instead of only £300 millions, the total money income liable to taxation would have been £4,000 millions, and a tax of 2s. in the £ would have yielded £400 millions instead of £380 millions; but it would be generally admitted that, notwithstanding this, such an increase in debt interest would be very far from *lessening* the burden entailed by any proposed expenditure amounting to a given total.

Though the net annual saving from a Capital Levy is thus necessarily less than the gross amount of interest on the debt redeemed by the levy, the importance of this difference between the gross and net figures is modified by the foregoing considerations.

PART V.

PROPOSED ALTERNATIVE MEANS OF DEBT REDUCTION.

Proposed Sur-tax on Investment Incomes.

235. We think it well also to consider alternative methods of raising funds for debt redemption from owners of accumulated wealth, which may be less liable to obstruction than is a Capital Levy.

236. The simplest method of doing this is to increase the present rates of Income and Super-tax on *investment* as distinct from earned incomes. This method raises no new problems of administration and requires no new machinery. Moreover, as was pointed out in evidence by Lord Bradbury, " Economically, a permanent charge on the income derived from capital is indistinguishable from a share of the capital itself " (*E. in C.*, 29). A charge upon investment income is, in fact, a Capital Levy in an alternative form. Since it necessarily spreads the repayment of debt over a longer period than would a Capital Levy, such a charge is to that extent inferior to a levy as a means of debt redemption; but it avoids certain of the difficulties attaching to so large and novel an experiment as a Capital Levy.

237. In this connection we are interested to notice that Lord Bradbury further expressed himself as in agreement " with the advocates of a Capital Levy that the method by which the interest and Sinking Fund on the debt is at present provided tends to discourage personal exertion and saving," and as favouring " alterations in the Income Tax, Super-tax and death duties under which that portion of them which is required to meet the debt-charge would become, even more completely than it is, a burden on *rente* generally, rather than an attempt to liquidate the debt itself by a levy on capital " (*E. in C.* 29).

238. An increase in the present differentiation between earned and investment incomes may be defended also on general grounds. An investment income involves a capital fund behind it; and, as we have already pointed out, the possession even of a moderate capital fund makes all the difference between economic security and insecurity. Moreover, the growing tendency of public opinion to regard earned as more meritorious than investment incomes appears to us both just and reasonable. It is admittedly desirable to discourage persons from living on the proceeds of invested wealth (that is, ultimately, on the labour of others), without themselves engaging in any useful activity; or, at least, to require from those who do so a substantially larger contribution towards public purposes than is paid by those who live upon the fruits of their own labour.

239. It must always be a matter of opinion whether any given differentiation between the rates of taxation upon earned and upon investment incomes is sufficient to counterbalance these differences in the character of the two types of income. In our view, the present (1926-27) differentiation, under which earned income enjoys a rebate of one-sixth, subject to a maximum allowance of £250, is not adequate.

240. *Since we wish to raise additional sums for debt redemption from owners of invested wealth, we think that, if there be no Capital Levy, this might well be done by increasing such differentiation.*

241. This proposal has, in our judgment, one further merit which should go far to commend it. In the section of our Report dealing with taxation we have discussed in some detail the possibility that existing direct taxation may imperil the accumulation of an adequate capital fund. Though we have given grounds for believing that this possibility is not at present realised, we are aware that, if the proceeds of taxation upon the rich are increasingly used to raise the standard of living of the poor, as on general grounds we hope will be the case, the possibility may have to be reckoned with.

242. Taxation of investment incomes for the purpose of debt redemption seems to us, however, to provide one certain safeguard against undue reduction of savings by redistributive taxation. As we have already pointed out, to meet this taxation taxpayers must certainly curtail their expenditure to some extent; but the debt holder in practically all cases treats money handed over to him in repayment of his holding not as income, but as capital. The whole process involves, therefore, a measure of compulsory saving.

243. We attach great importance to this point. It has been suggested to us in evidence by many of our witnesses that a reduction of direct taxation would be in the best interests of all classes, since the money remitted would be saved and invested and become the means of employment. At best, this is a dubious method of promoting saving, since remission of direct taxation means to the taxpayer an increase of *income*, and there is no means of knowing how far he will employ this in increased expenditure, and how far in increased saving.

244. *Taxation of income for debt redemption, on the other hand, is a certain method of transferring money from income to capital*, i.e., *of increasing savings*. The risk, therefore, of a dangerous diminution of the national capital, which attaches to severe increases of direct taxation of income for other purposes, is practically eliminated in the case of taxation for debt redemption. We need not, therefore, hesitate to propose that large investment incomes should bear a considerable weight of taxation for this purpose.

245. *We recommend, therefore, that, if there be no Capital Levy, an additional annual charge be imposed upon investment incomes for the purpose of debt redemption.* By this we do not intend that the proceeds of such taxation be so earmarked for debt redemption by statute that they do not enter into the general Budget revenues at all. We are, in general, opposed to the rigid allocation of any taxes to specific objects; and we think that the objections to this course apply no less in the case of the new taxation which we are suggesting than to the earmarking of existing taxes for particular purposes. At the same time, we wish it to be understood that we are putting forward this proposal with the object of safeguarding the more rapid redemption of the debt, and of ensuring that sufficient funds will be available for this purpose, notwithstanding any increase of expenditure which the nation may be called upon in the future to incur.

246. As regards the amount of such taxation, we think that it would be reasonable to aim at an annual sum of £100 millions. We understand that, as far as Income Tax is concerned, about 70 per cent. of the present yield comes from investment income, and that the mere restoration of the standard rate of tax upon *investment* incomes only to the level (6*s.* in the £) charged upon *all* incomes as recently as 1921-22 would yield about £85 millions.

247. We quote this figure, however, merely for illustrative purposes to give an idea of the scale of our proposal. We do not suggest that the bulk of the additional revenue which we desire to raise should be obtained by an increase in the standard rate of Income Tax upon investment incomes. On the contrary, *we think it most important that this revenue should be raised by graduated taxation, and that whatever the precise form of tax adopted, its graduation should be at least as steep as that of the present Income Tax and Super-tax together.*

248. We understand that for administrative purposes no complete division of all income liable to Income Tax and Super-tax into earned and investment income, respectively, is at present made. Our proposal would necessitate such a distinction, which would, we think, be valuable in itself for the incidental information which it would yield as to the proportions in which income is divided between earners and owners. In view, however, of the already complicated character of the present Income Tax and Super-tax, with their appropriate allowances and reliefs, we think it might be found convenient to raise the additional revenue not by an adjustment of the rate of those taxes charged on unearned income but by the introduction of a special graduated Sur-tax applicable to investment income alone. The proposal would have the additional advantage that the exceptions and reliefs allowed under the new tax need not necessarily be the same as those provided under the present Income and Super-tax.

PROPOSALS AS TO DEATH DUTIES.

(i) *General Views on the System.*

249. In addition to the proposals already given, we think that further funds for debt redemption might also be found from an extension of the present system of death duties.

250. We have heard much evidence on the general subject of the death duties, many witnesses being strongly opposed to the whole principle involved in this form of taxation, while others regarded the tax as a useful means of revenue of which the burden is comparatively little felt, and which complements in important particulars our system of taxation upon income.

251. In our judgment, the taxation of property passing at death has much in principle to recommend it. In the first place, inheritances are a principal cause of that inequality in the distribution of accumulated wealth which is so ugly a feature of our civilisation; and particularly of such inequality as bears no relation to differences in industry or social usefulness. Second, in spite of " legitimate expectations," a great deal of property received by inheritance undoubtedly comes as something of a windfall to the recipient, and as such is a peculiarly fit subject for taxation. Third, death duties, being assessed upon capital, bring under taxation such assets as household property or speculative gains by way of capital appreciation, which do not yield, and cannot themselves be classed as, " income."

252. We have, therefore, to consider whether the objections to death duties which have been raised in evidence before us are sufficient to outweigh these advantages. These objections are, primarily, that the taxes are destructive of capital, and, secondly, that they fall with great hardship on the owners of private businesses and landed proprietors, whose resources are not available in liquid form.

253. We are not impressed by the force of these objections. The first appears to us to be based on a misunderstanding. *Though death duties are assessed on capital they destroy no existing capital; at most they absorb potential capital by diverting to the payment of the duties income which would otherwise have gone into new savings. In this they do not differ from Income Tax or any other tax of comparable magnitude.* Even where estates are sold to meet the duties, capital is only transferred, not destroyed. The property sold must eventually be bought by someone who has free income seeking an investment, and the only effect is to divert this income from the creation of a new, to the purchase of an existing, investment. There is no reduction of actual capital.

254. The difficulties which death duties occasion for those whose wealth is not available in liquid form appear to us to be greatly exaggerated. We have already referred to the evidence submitted by the Board of Inland Revenue in regard to the

place of private businesses under a Capital Levy, which indicated that proprietors of such businesses normally have the bulk of their wealth outside their trade assets altogether. This evidence was strikingly confirmed by a further investigation into the position of 373 estates left at death by owners of private businesses. It was found that, if all the debts were apportioned evenly over all the assets of the estates, in only three cases were the non-trade assets insufficient to meet the whole Estate Duty charge; whilst, even if the debts were treated as a charge only on the non-trade assets, in only 12 cases would this have been the position.

255. As regards landed proprietors also, we have heard no evidence to convince us that any difficulties are not adequately met by the existing reliefs in the case of quick successions, and the extended period allowed for payment.

256. *In our view the death duties are a most valuable source of revenue of which by no means adequate use has already been made.* As we do not regard these taxes as " coming out of " capital, we differ from those of our witnesses who wished the proceeds of the taxes to be earmarked for debt redemption. Since, however, we are concerned to find additional funds for repayment of debt, it is in this connection that we put forward our proposals for extension of the present system of death duties.

(ii) *Possibilities of an Inheritance Tax.*

257. The main death duty at present levied is the Estate Duty, charged on the whole property left by the deceased, and graduated in accordance with the size of this property. The Legacy and Succession Duties, charged on property received by successors, play a minor part. We are disposed to think that it would be desirable to relate the graduation of death duties more closely to the wealth of the successors than is done under this system. It seems unreasonable that a millionaire, receiving a bequest of £1,000, should pay no higher rate of duty on this than does a person whose whole property prior to the bequest amounts to no more than a few hundreds. Since, however, we have taken no detailed evidence upon this point, and have been unable to give full consideration to the proposals necessary to carry out any change, we abstain from making any definite recommendation, and express only the view that graduation in accordance with the wealth of the recipient seems to be a principle deserving of recognition in any system of death duties.

(iii) *The Rignano Proposal for Modification of Estate Duty.*

258. *The present rate of Estate Duty is graduated up to a maximum charge of* 40 *per cent. on estates of* £2,000,000 *and upwards. We think that, even apart from any changes in the principles of graduation, the present scale leaves a considerable margin for increase.*

259. We have, however, given some attention to the proposals put forward by Professor Rignano for alteration of the basis of graduation of death duties, such as might be applicable to the British Estate Duty. The wide scope of our enquiry has prevented our obtaining detailed evidence on this proposal, which indeed has not anywhere, so far as we are aware, yet been attempted in practice. We think, however, that the plan is of sufficient importance for us to record the results of our preliminary consideration of it, and the conclusions to which these appear to lead.

260. Professor Rignano's proposal is, in short, that, in addition to graduation of Estate Duty in accordance with the size of the deceased's estate (and in addition to any other duties introducing graduation according to the degree of relationship, or the existing wealth of the inheritor, or the amount of individual bequests), the rates of duty should be differentiated according to what may be termed the "relative age" of the estate—that is to say, the number of times that the deceased's property has already been the subject of inheritance and bequest. Thus, if A dies leaving £500,000, of which £300,000 was accumulated by himself during his own lifetime, and £200,000 had been inherited by him from his father, a heavier rate would be charged on the latter than on the former sum.

261. In its most elaborate form the proposal would distinguish three rates of duty, running up to 100 per cent. in the case of the third transfer, so that after three successions the whole balance of any estate would pass to the State. The following simple examples show how this system would work. (For the sake of simplicity, graduation on the existing system is ignored; it can, of course, easily be superimposed upon graduation on the Rignano plan.) Rates of 30 per cent. on the first, 60 per cent. on the second, and 100 per cent. on the third transfer are assumed.

	A inherits nothing and accumulates from his own business, &c., £100,000.
First transfer ...	At A's death the State takes duty at 30 per cent. (*i.e.*, £30,000) leaving £70,000 to be inherited by B.
	B increases this by his savings to £200,000.
Second transfer ...	At B's death the State takes duty at 60 per cent. on £70,000 (*i.e.*, £42,000) and at 30 per cent on £130,000 (*i.e.*, £39,000)
	£81,000
	leaving £119,000 to be inherited by C.
	C increases this to £250,000.

Third transfer ...	At C's death the State takes duty		
	at 100 per cent. on	£28,000	(*i.e.*, £28,000)
	at 60 per cent. on	£91,000	(*i.e.*, £54,600)
	at 30 per cent. on	£131,000	(*i.e.*, £39,300)
			£121,900

A's original £100,000 is thus reduced by £30,000 to £70,000 at the first transfer; by £42,000 to £28,000 at the second transfer; and by £28,000 to nil at the third transfer.

262. A simpler method of achieving the principal results which it is hoped to derive from this proposal would be to distinguish only two rates of duty—one applicable to all wealth received by inheritance (or gifts, which for this purpose must be treated exactly as inheritances) whatever its " relative age," and one to that portion of the estate accumulated by the deceased's own actions during his own lifetime. Supposing these two rates to be 60 per cent. and 30 per cent., the foregoing example would work out as under :—

At A's death the State takes duty		
at 30 per cent. on £100,000	£30,000	
At B's death the State takes duty		
at 60 per cent. on £70,000	£42,000	and
at 30 per cent. on £130,000	£39,000	
	£81,000	
At C's death the State takes duty		
at 60 per cent. on £119,000	£71,400	
at 30 per cent. on £131,000	£39,300	
	£110,700	

263. The exact amount of revenue derived by the State depends, of course, not on the number, but on the adjustment of the rates, so that no inference is to be drawn from the chance figures of £232,900 and £221,700, representing the total duty paid at the three deaths in the above examples.

264. In any case it is evident that the full yield of any duties graduated according to relative age could not be available until after the lapse of a considerable period. To this extent, therefore, any proposal on these lines is necessarily secondary, as a means of debt redemption, to more immediately remunerative measures such as a Capital Levy or an annual tax on investment incomes.

265. As regards the actual introduction of the system, we understand that Professor Rignano suggested that, in the case of all deaths occurring after the appointed day, a certain proportion of the deceased's property should be deemed to have been the result of his own activities and the remainder of inheritance from others. We think, however, that any such convention would operate too inequitably as between individuals, and that it would be necessary at each death to charge the higher rate of duty only upon sums that the deceased had actually received, since the appointed day, by way of gift or inheritance, and to face the consequential delay in realising the full yield of the duties.

266. We have no doubt that the administrative problems involved in the simpler proposal under which only two scales of duty would be applied—one to the property accumulated by the deceased, and one to property received by him from others—would be very much less intricate than those that would arise from more elaborate differentiation; and since the chief advantages which commend the idea underlying the proposal in either form appear to be realised in the simpler plan, it is to this, rather than to the more elaborate scheme, that our remarks in what follows are primarily addressed.

267. Of these advantages the chief, in our opinion, is the fact that *an Estate Duty graduated according to "relative age" appears to be guiltless of the charge of discouraging enterprise and saving, which is brought against all other forms of direct taxation.* The knowledge that the State will take a substantial part of a man's fortune at his death *may*—though we doubt if it often does—induce him to dissipate, or at least to refrain from increasing, that fortune during his lifetime. We cannot, however, believe that the actions of anybody are materially affected by the prospect of taxation occurring, not in his own lifetime, nor even at his own death, nor in the lifetime of his heirs, but only at the death of those heirs. In consequence, graduation according to "relative age" means that, in the case of wealth not due to the deceased's own efforts, very high rates of taxation indeed might be imposed without raising the bugbear of diminished enterprise and saving.

268. Indeed, we agree with Professor Rignano that the effect of a duty graduated on this basis would be positively to stimulate enterprise and saving, particularly on the part of those who have inherited money and who would themselves benefit by some such stimulus, no less than would the community as a whole. Knowing that an inheritance is a wasting asset in a sense not applicable to the proceeds of his own efforts, a man is the more likely to use those efforts at least to maintain the total that he can pass on to his own heirs at the figure which he himself received. The very fact that the net

value, for inheritance purposes, of every pound earned or accumulated by himself is higher than that of every pound received from somebody else should be in itself an inducement to concentrate upon the former rather than upon the latter method of acquiring a livelihood.

269. The most serious objection to the Rignano system of graduation which we have encountered is that it would operate unfairly in cases in which property received by inheritance depreciated (or, we may add, appreciated) through causes outside the owner's control. Thus, if "A" inherited land worth £100,000 which, owing to a change in the amenities of its situation, subsequently depreciated to £80,000, and made good the difference by himself accumulating £20,000, so that he still died worth £100,000, he would be charged at the higher rate on the whole of his property, although £20,000 was strictly the result of his own activities. Conversely, if the value of the land appreciated to £120,000, and "A" added nothing at all to his inheritance, the State would only get the lower rate of duty on the additional £20,000, though "A" had done nothing to create this.

270. While we see some force in this objection, we do not think that it is sufficient to outweigh the merits of the whole proposal. *The inequality, in our view, lies not so much in differentiation of the rates of duty as in the fact that some people's property appreciates while other's does not;* and for this no system of taxation is to blame. Under the present system, of two persons both dying worth £200,000, of whom one has made practically the whole of his fortune by his own enterprise, and the other has had thrust upon him, by inheritance, the riches created by other people, both pay the same charge. We are disposed to believe that, in general, the inequitable contrasts arising under the Rignano system, combined with the present system of graduation, would be less than those now commonly arising in such cases as we have quoted. We think, however, that provision might reasonably be made, if it were proposed to introduce the Rignano system, for appeals (on both sides) in the case of serious hardship arising out of severe fluctuation in values.

271. *The result of such consideration as we have been able to give to this proposal is certainly to suggest that the principle of graduation according to the "relative age" of estates might, with great advantage, be introduced into the British system of death duties.* If this principle were superimposed upon the existing graduation of Estate Duty, so as materially to increase, at all transfers other than the first, the scale of duties now chargeable, it would be the means of raising a substantial amount of fresh revenue for increasing, as we suggest, the sums now devoted to debt redemption.

272. We have admittedly not been able to consider in detail the administrative problems which this novel form of graduation must raise. So far as we have been able to ascertain, however, these should not present any insuperable difficulties, and we understand that such also is the view of the Board of Inland Revenue. It should be understood that, in order to carry out such graduation, it would not be necessary for the Inland Revenue authorities to keep record of the actual life history of each physical portion of an estate, e.g., a given block of railway shares, but only of the aggregate values received by inheritance by each individual during his lifetime and left by him at his death—facts which already come to their notice in administration of the present Estate, Legacy and Succession Duties.

SUMMARY OF REPORT.

PART I.

The Debt and its Effects.

An analysis is given of the debt and the interest charge. The popular estimate that the payment of interest on the debt costs a million pounds for every working day in the year is found substantially accurate (*paras.* 2 to 10).

The burden of the *external* debt consists in the reduction of the real national income of this country. The burden depends upon conditions which we can neither foresee nor control (*paras.* 11 to 16).

The internal debt involves a transfer, but not any destruction, of purchasing power and limits the sums available for increased expenditure on other services (*paras.* 17 to 41).

The effects of the Floating Debt are of a special character. We think it important that the amount of debt retained in this form should be strictly limited (*paras.* 42 and 43).

It is beyond question that the internal debt involves, on balance, a transfer of wealth and income such as aggravates the existing inequality in distribution and tends to increase the proportion of the national income in the hands of non-producers (*paras.* 44 and 45).

The burden of the debt has been very gravely increased by the recent fall in the general level of prices. A rough estimate indicates that over two-thirds of the post-war debt was raised when the value of money was lower than at present, while the remainder was raised when the value of money was higher than it is to-day (*paras.* 46 to 52).

There is no trustworthy evidence as to the future course of prices for more than very short periods. It is unlikely that such automatic relief as occurred in the burden of the debt after the Napoleonic wars, through expansion of the population and wealth of the country, will be repeated in the case of the present debt (*paras.* 53 to 63).

PART II.

Taxation.

An analysis of the distribution of taxation for different income levels shows that the burdens of taxation on family incomes of £200 and under are evidently very heavy. We infer that a considerable part of the wage-earning population must be seriously over-taxed (*paras.* 64 to 68).

Taxation upon commodities, regarded as part of a general system for raising the money required for State expenditure, appears to us objectionable in principle. The objection rests

primarily on the regressive character of such taxation. The general objections to indirect taxation apply with special force to the taxes upon food, entertainments and artificial silk. We recommend that, subject to the needs of fresh expenditure, any future surplus of revenue should be devoted primarily to the abolition of these duties (*paras.* 69 to 76).

We attach no importance to the maintenance of any particular ratio between the sums raised by direct and indirect taxation. We do not think that the merits of our suggestions are invalidated by the fact that, if these were carried out, they would enable a section of the community to escape national taxation altogether. Only those citizens would be exempt from taxation whose means are inadequate to support a reasonable standard of life (*paras.* 77 to 80).

We have heard much general evidence dealing with the injurious effects of direct taxation upon industry and trade, but practically no quantitative evidence upon the subject (*paras.* 81 to 86).

If the contention that direct taxation is highly injurious to trade and prosperity is valid, we should expect to find some correlation between movements in the level of such taxation and movements in the rate of unemployment. We find absolutely no correlation (*paras.* 87 to 90).

The view that direct taxation, other than that levied for the service of the external debt, actually reduces aggregate purchasing power appears to us to be entirely a misconception (*paras.* 91 and 92).

We are unable to accept the doctrine that direct taxation raises prices generally (*paras.* 93 to 99).

We are of opinion that the influence of direct taxation upon the output of *work* can now have but little importance and must have greatly diminished in recent years (*paras.* 100 to 107).

We are of opinion that direct taxation does not seriously impair the *incentive to save* on the part of individuals, and that those who have expressed a contrary view have not fully appreciated the distinction between the effects of taxation upon the incentive and upon the ability to save (*paras.* 108 to 118).

We do not find that existing direct taxation destroys the incentive to save on the part of joint stock companies, and we notice a remarkable stability in the allocations made by companies to reserve (*paras.* 119 to 122).

The effects of taxation upon the capacity to save cannot be considered apart from the use made of the funds raised by such taxation. Such part of the tax revenues as is used for payment of the internal debt interest, and still more such part as is used for repayment of the internal debt, appears to us to be distributed in a manner definitely favourable to saving. Some part of the tax revenues spent on the general civil services and the defence forces is distributed in a manner definitely prejudicial to saving. Looking at both sides of the account, and attempting

to estimate the quantitative importance of the figures, we are unable to see any cause for the plea that direct taxation, as at present imposed, and as at present spent, can seriously reduce aggregate savings. We are of opinion that the causes of the known decline in actual savings must be sought elsewhere than in taxation (*paras.* 123 to 133).

We are of opinion that existing direct taxation is not seriously prejudicial to enterprise, and that those who take a contrary view have taken account of one aspect only of such taxation to the exclusion of others. In practice, the alternative to industrial investment, the yield of which is reduced by taxation, is investment in some form of bond, the yield of which is also reduced by taxation. Cases in which a *disproportionate* reduction of the yield of speculative investments occurs do not appear to us to be of sufficient importance, or (what is no less important) to be sufficiently often anticipated by persons who have capital at their disposal, to have a material effect upon industry generally (*paras.* 134 to 139).

Our general conclusion as to existing direct taxation is that it cannot reduce aggregate purchasing power, and that it does not raise prices or materially reduce the national output of work, of saving, or of enterprise (*para.* 140).

PART III.

Methods of Debt Reduction; Sinking Funds and Conversion.

An analysis is given of the existing sinking fund arrangements for redemption of the debt. The New Sinking Fund, on which alone it is possible to count with any degree of certainty, will require a period of 153 years in which to redeem the whole debt (*paras.* 141 to 145).

We doubt if it is clearly understood that the sums necessary to meet specific sinking funds attached to particular loans are included in the New Sinking Fund total of £50,000,000 per annum. We cannot agree that a sinking fund spreading repayment over so long a period as 153 years is at all adequate (*paras.* 146 to 149).

An estimate is given of the savings which might be anticipated from reduction of the debt by conversion as opportunity offers to a 4½ per cent. and also to a 4 per cent. basis. The gross savings in interest thus obtainable would amount to £15,109,000 per annum and £33,099,000 per annum respectively. If conversions are effected on these lines as the various loans mature, the great bulk of the saving would not arise until the end of a period of nearly a quarter of a century. If conversions are effected at the earliest dates on which the Government has an option of repayment, the greater part of the gross saving might be realised within eight years. Owing to loss of Income Tax and Super-tax on the interest saved, the actual net savings possible would fall short of the figures given (*paras.* 150 to 161).

The prospect of all savings from conversion depends upon the assumption of a fall in the general rate of interest. We can find neither more nor less evidence in support of this than in support of an exactly opposite assumption. We conclude that the savings from conversion are necessarily limited in amount, offer no prospect of immediate relief, and are wholly contingent upon an assumption for which we have not been able to find any evidence (*paras.* 162 to 165).

PART IV.

The Capital Levy.

We have considered the scheme submitted to us by several witnesses for redemption of the debt by a Capital Levy, and have directed our attention principally to the scheme for a levy of £3,000,000,000 submitted by the Trades Union Congress General Council (*paras.* 166 to 168).

We estimate that if a levy of £3,000,000,000 were imposed to-day, it would be necessary to adopt a scale of 20 per cent. greater severity than that put forward in the Trades Union Congress evidence (*para.* 169).

The primary advantage claimed for the Capital Levy is that it will reduce the National Debt on a large scale in the immediate future (*paras.* 170 and 171).

In the second place, attention is drawn by advocates of the levy to the net annual saving on the Budget resulting from a levy We find that, in the case of a levy such as that proposed, this net annual saving (i.e., the excess of the reduction of interest on debt repaid over the loss of taxation consequent on a levy) would be £48,000,000 in the case of a levy of £2,500,000,000, and nearly £58,000,000 in the case of a levy of £3,000,000,000 (*paras.* 172 to 175).

Advocates of the levy claim that this net annual saving would remain assured in perpetuity (*paras.* 176 and 177).

The Capital Levy is represented by its advocates as imposing the burden of war expenditure upon the shoulders best fitted to bear it. They point out that, so long as there is no levy, with every year that passes there is a steady increase in the proportion of taxpayers who are meeting the cost of a debt over the creation of which they had no control (*paras.* 178 to 182).

Our attention is also called to the contrast between the very large profits made during the War by some who were exempt from military service and the risks and hardships incurred by those who served in the Forces (*para.* 183).

Finally, our attention is drawn to the heavy increase in the real burden of the internal debt consequent upon the recent fall in prices (*para.* 184).

The principal argument *against* the equity of the Capital Levy is that it involves a penalisation of thrift which is both unjust and economically indefensible. It is further urged that

the supposed contrast between those who fought in the War and those who stayed at home and made money out of it is unjustifiably simple and becomes increasingly unreal with the lapse of time (*paras.* 185 to 191).

In balancing the conflicting considerations of equity regarding a Capital Levy, we conclude that a strong case has been established for imposition upon owners of accumulated wealth, in a steeply graduated form, the taxation incidental to any large repayment of debt at an early date (*para.* 192).

In 1919 the Board of Inland Revenue expressed the view that a levy on War Wealth was not outside the range of practicability. In considering the applicability of this conclusion to the problem of a Capital Levy, they give no reason for supposing that a Capital Levy is a less practicable proposal than a levy on War Wealth, while in some important technical respects they find that it is definitely easier (*paras.* 193 to 197).

We do not find that the difficulties of valuation involved in a levy would be insuperable (*paras.* 198 to 202).

We do not find that a Capital Levy would destroy any existing capital (*para.* 203).

We conclude that the effect of a levy on potential capital, that is, on savings, is a matter which affects not so much the general question of the desirability of a levy as the circumstances in which it is most likely to be successful (*paras.* 204 to 208).

The fear that a Capital Levy would drive capital from the country has, we think, been greatly exaggerated (*paras.* 209 to 211).

We see no reason to anticipate any general fall in security prices as a result of a levy, though we think that industrial stocks might depreciate relatively to gilt-edged securities. We are of opinion, however, that such disturbances would be necessarily of a temporary character (*paras.* 212 to 217).

We have had conflicting evidence as to the effect of a levy upon the general price level. In the main, we think that the levy would not cause deflation of credit and prices generally. We think that it might materially modify the distribution of borrowing power between individuals (*paras.* 218 to 223).

We do not think that the payment of a levy by private businesses would give rise to insuperable difficulties, or that payment by instalments would be necesssary in more than a minimum number of cases (*paras.* 224 to 227).

We do not think that a levy need cause unemployment, though we do not doubt that it might have this effect in consequence of misunderstanding or panic or obstruction (*paras.* 228 to 230).

We have no hesitation in saying that a Capital Levy could have been carried out comparatively easily in 1919 or 1920, and that it is a matter for great regret that no levy was then imposed. A Capital Levy would still, in our judgment, be the best method of dealing with the debt, provided that it were generally approved

and were assured fair treatment by the taxpayers. The nation may yet turn to the Capital Levy as a wise and practicable measure affording the best road out of its difficulties (*paras.* 231 to 234).

PART V.

Proposed Alternative Means of Debt Repayment.

As an alternative method of raising funds for debt repayment from owners of accumulated wealth, which may be less liable to obstruction than a Capital Levy, we suggest the imposition of additional taxation on unearned income. We think that an increase in the present differentiation between earned and investment incomes may be defended on general grounds. Further, taxation of invested incomes for the purpose of debt repayment seems to provide one certain safeguard against undue reduction of savings by redistributive taxation (*paras.* 235 to 244).

We recommend that, if there be no Capital Levy, an additional annual charge be imposed upon investment incomes for the purpose of debt redemption. As regards the amount of such taxation, we think that it would be reasonable to aim at an annual sum of £100,000,000. The graduation of such taxation should be at least as steep as that of the present Income Tax and Super-tax together. We think that it might be desirable to raise this revenue by the imposition of a special tax on unearned incomes rather than by adjustment of the rates of Income and Super-tax now charged on those incomes (*paras.* 245 to 248).

We think that further funds for debt repayment might be found from an extension of the present system of death duties. The taxation of property passing at death has much in principle to recommend it. The objections that such taxation is destructive of capital, and falls with great hardship upon the owners of private businesses and landed proprietors, appear to us to be much exaggerated (*paras.* 249 to 256).

We think that the principle of an inheritance tax graduated in accordance with the wealth of the recipient of an inheritance seems to be a principle deserving of recognition, but have taken no detailed evidence on the matter (*para.* 257).

We have given some attention to the proposals put forward by Professor Rignano for graduation of death duties in accordance with the number of times that the deceased's property has already been the subject of inheritance and bequest. We think that these proposals have the advantage that such graduation appears to be guiltless of the charge of discouraging enterprise and saving. Indeed, we agree with Professor Rignano that it would positively stimulate enterprise and saving (*paras.* 258 to 268).

The most serious objection to the Rignano system of graduation which we have encountered is that it would operate unfairly in cases in which property received by inheritance depreciated or appreciated through causes outside the owner's control.

While we see some force in this objection, we think that the inequity lies not so much in differentiation of the rates of duty as in the fact that some people's property appreciates while other's does not (*para.* 269).

The result of such consideration as we have been able to give to the proposal is to suggest that the principle of graduation in accordance with the Rignano principle might with great advantage be introduced into the British system of death duties. We understand that the administrative difficulties would not be insuperable (*paras.* 270 to 272).

We wish unreservedly to associate ourselves with our colleagues on the Committee in expressing our indebtedness to the Secretary, Mr. G. R. Hamilton, and the Assistant Secretary, Mr. G. Ismay, and our warm appreciation of the invaluable assistance which they have given at every stage of the enquiry.

We have the honour to be,

My Lords,

Your obedient Servants,

J. W. BOWEN.
FRED HALL.*
H. B. LEES-SMITH.
BARBARA WOOTTON.

15*th November*, 1926.

---

* Signed subject to the following reservation.

RESERVATION BY PROFESSOR FRED HALL.

1. I have signed the Minority Report of the Committee as I am in general agreement with the conclusions on the "incidence and effects of existing taxation." I also share the views expressed therein upon many aspects of the debt problem, but I regret that I am unable to concur in the proposals made for the redemption of the National Debt. Whilst I am in greater sympathy with the recommendations on that point contained in the Minority Report than with those in the Majority Report, there are some features of the recommendations in the former which I regard as unsatisfactory. I wish, therefore, to submit separate proposals.

2. The grounds upon which the Majority Report supports a measure of steady repayment are briefly:—(*a*) to improve the national credit, with particular reference to the result upon future conversion operations; (*b*) to facilitate future borrowings should circumstances make this course imperative; and (*c*) to reduce the risk of an increase in the burden of the debt-charge through a fall in the price level. In my view these grounds indicate need for a greater effort to reduce the debt than is proposed by the majority. Particularly in view of the very great opportunities which will occur in the next few years for converting debt, I am of opinion that a strong reinforcement of the Sinking Fund is necessary in order to create the most favourable conditions for conversion during that period. I share the view of my colleagues that, on the whole, taxation for debt redemption is beneficial to savings, and that money applied to redemption will, in the first instance, seek outlet in the gilt-edged market. I think, therefore, that the conditions for conversion will be improved by expediting the repayment of debt over a period of, say, five years, and that the limitation of the necessary additional taxation to this short period will avoid many of the harmful effects which might be anticipated to follow the imposition of heavy additional permanent taxation, such as is suggested in the Minority Report. Failing some such operation as the Capital Levy, it is clear that the payment of interest on a large body of debt must in any circumstances continue for a very long period. Even fractional savings in conversion terms (assuming that long period or funded loans are issued) become of importance in these circumstances, and in my view the proposals in the Majority Report fail to make the most of the opportunity offered.

3. I am inclined to attach more importance than some of my colleagues to the risk of an increase in the burden of the debt-charge through a fall in the price level. The extent of that risk depends largely upon future economy in the use of gold. While the position is very uncertain, it seems to me that considerations

of safety indicate the need for a more vigorous debt policy in the *immediate* future than is suggested by either group of my colleagues.

4. I am also averse to the creation of a feeling in the community that the amount of the debt does not matter so long as interest charges are paid. If past history is any guide, the incentive to redeem debt will become less and less as time goes on; I think it important, therefore, to set a high present standard of repayment which may have an influence on future generations.

The amount of the debt, and the consequent taxation, will obviously become important if the Government becomes a large borrower again; prudence suggests that this is a further reason why an effort should be made to effect a substantial reduction in the amount of the debt.

5. For these reasons the proposal of the Majority Report that the debt should be dealt with by a Sinking Fund gradually increasing to £75 millions over the next few years seems to me insufficient. That Report, it is true, contemplates an increased effort in the more distant future, but I have indicated my view that more is required in the period immediately ahead.

6. The proposals in the Minority Report for accelerating debt redemption are based in the main upon an increase of taxation upon investment incomes. In addition to reducing debt more slowly and increasing taxation for a longer period than I think desirable, the scheme has the defect that it would throw none of the extra burden of debt repayment upon earned income, though in the case of many persons some of this income is, in part, a return upon capital invested in training for their occupations.

7. The alternative proposal for non-recurrent supplementary taxation submitted below is designed to avoid the deterrent effects upon saving and enterprise which normally proceed from high *permanent* taxation, even though in some respects these effects are tempered where the proceeds are applied to debt redemption. This consideration, combined with the fact that the tax is a general contribution from all direct taxpayers, satisfying the principle of ability to pay, would probably secure for it a more general measure of acceptance than would be accorded to schemes falling only upon particular classes. It is of importance also to note that no new machinery would be required for the working of the scheme.

8. I recommend that steps should be taken to effect a reduction of, say, £1,500,000,000 in the debt by the employment of present fiscal methods and machinery. For this purpose I propose—

(*a*) that the sum of about £1,000 millions should be raised over a period of five years by a non-recurring war-debt-redemption tax in the form of a supplement on (*a*) income taxation and

(*b*) death duties, the proceeds being definitely assigned to the repayment of debt.

(*b*) that the proceeds of the above taxation should be supplemented for the period of five years by the present Sinking Fund of £50 millions; by the sums received in respect of reparations and allied war debts; by the amount of the reduction in debt interest; and by any budget surpluses. While the sums available from these sources cannot be definitely foreseen, it seems not unreasonable to estimate that approximately £500 millions should be available in the period of five years.

9. It is proposed that the above sum of £1,000 millions should be raised from additional income taxation on Income Tax and Super-tax payers to the extent of, say, £850 millions, and from death duties to the extent of, say, £150 millions, though the precise division between these sources might be subject to slight modification.

10. The supplementary income taxation should, it is suggested, fall upon all persons liable to Income Tax, and in the case of large incomes should be more steeply graduated than the present combined Income Tax and Super-tax. Even if the present rates of taxation are increased by an addition necessary to secure an annual increase of £170 millions to £180 millions, the rates would probably be, for all but a relatively small number of persons, no higher than those in force a few years ago.

11. The additional revenue from death duties should be obtained by an increase throughout the scale of duties, supplemented by an additional increase in the case of the intermediate range of estates. Since the additional Income Tax proposed above will have been paid on the income of estates falling in after the first year, it is suggested that the addition to the death duties should be on a scale diminishing yearly, but designed to produce approximately £150 millions over the period of five years.

12. It appears reasonable to assume that the redemption of some £1,500 millions of debt under this scheme would result in a reduction on the present interest charge at the end of the five year period of from £65 millions to £70 millions. Whether or not any considerable reaction upon the future yield of taxation would follow from the scheme is uncertain; clearly it would not approach the degree of importance involved in the proposals for a Capital Levy. I will assume, however, that the interest saving will be offset to some extent by the reactions on tax revenue, and that, at the end of the five year period, the disposable net amount will be somewhere between £50 millions and £65 millions.

13. I recommend that of this net amount £50 millions should be used to raise the Sinking Fund to £100 millions at the end

of the five-year period, the balance, together with the amount of reparation receipts and repayments in respect of allied debts, being then set free for general application in the Budget. Unless offset by increased expenditure, this application should make possible an immediate reduction in the amount required to be raised in taxation. Under this suggestion the balance of the debt would be redeemed in about 60 years. I propose, however, that the Sinking Fund should be progressively increased, until it reaches the sum of £125 millions, by the addition of one-half of the annual saving in the interest charge. That point would be reached in about 15 years from now and the scheme should enable the whole debt to be redeemed in a further period of about 40 years, though some scaling down towards the end of the period would no doubt be necessary.

14. It will be obvious that my proposal merely outlines the general basis upon which I think the debt policy should be framed, while indicating the sources from which, in my view, the additional taxation necessary in the early period should be drawn. In detail the scheme would no doubt require to be adjusted in some respects. In particular I should make it clear that the figures of savings quoted are illustrative rather than actual, and it will be well understood that I am unable to give consideration in the scheme to other factors which may affect future rates of taxation.

FRED HALL.

COMMITTEE ON NATIONAL DEBT AND TAXATION.

INDEX.

Numbers refer to paragraphs.

Agricultural Estates:
Break up of, taxation as a cause of, 506.
Capital levy and, 802.
Estate duty on:
Amenity value, 508-9.
Effects of, 505-12, 547.
Special relief, 506, 512.

Alcoholic drinks, duties on:
see also Customs and Excise Duties.
Burden of, on specimen incomes (1903-4, 1913-14, 1918-19, 1923-24, 1925-26), 241-2, 248-52, 255, 642, 649, 654.
Consumption restricted by, 590, 690.
Rates, prices and consumption from 1913-14, 638-54.
and Standard of living, 661, 663, 665, 667.
Total net receipts and duty per head (1913-14, 1923-24 to 1925-26), 593.

Allied debts:
Amounts due to Great Britain, 149-50.
Principal repayments, allocation to debt redemption approved, 999.

Banks:
Advances from:
Effect on:
of Capital levy, 771-90, 867.
of Debt redemption, 981-4.
to Private businesses, statistics, 779,84.

Bearer bonds:
Stamp duty on, *see under* Stamp Duties.

Beer, duty on:
see Alcoholic drinks.

British Investment Abroad:
Encouragement by debt repayment at present rate, not serious, 278, 385-6, 980.
Pre- and post-war comparison, 56.

Budget surpluses.
Application to debt redemption, 1003.
Debt reduction from (1920-21 to 1925-26), 110-5, 118.

Business, private:
Classes of, and distinction from the public company, 409-11.
Comparison with the profession, &c., 412-15.
Conversion into private limited company, position as regards stamp duty, 557.
Conversion into public companies, death duties as a factor, 504.
Effects on:
of Capital levy, 791-801, 868.
of Death duties, 499-504, 524, 547.
of Income Tax, 416-36, 443.
Position of, in connection with relief of Company reserves from taxation, 419.
Transfer of residence abroad, effect of income tax, 435-6.

Capital:
see also Saving and Savings.
Annual tax on, examination of scheme, 896-901.
Future requirements for employment of increasing population, 696-700.
Future requirements as a test of rate of debt redemption, 986-8.
Shortage, present, or future, question, 60, 389-90, 401-2, 693, 700.
Supply of:
Effect on:
of Estate duty, 513-34, 544, 547.
of Capital levy, 810-27, 869.
of Customs and Excise duties, 668-70.
of Direct taxes, 691-3.
of Income tax and super-tax, 380-91, 444, 447-8.
of Taxation for internal debt service, 260-5, 275-8, 696-7.

Capital issues:
Foreign, effect of stamp duty on, 564-5.
Government:
Bonds of which capital and interest to be paid according to official index number, Mr. Keynes' proposal, 1009-10.
Effect of capital levy on terms of, 766-8.
Rate of interest, effect of debt redemption on, 969-72.
Special tax privileges attached to, 171-81, 1008.
Industrial (1913, 1921, 1922, 1923), 55.

Capital Levy:
Adjustment to ability to pay, 853.
Advocates of, arguments put forward by, 704, 705.
on Agricultural landowners, 802.
Assessment, practicability, 711.
Comparison with forced loan and other schemes, 895.
Effects of:
if Badly received, 873-4, 876.
on Bank advances, 771-90, 867.
on Capital supply, 869.
on Credit, supply of, or demand for, 766, 771-90.
Deflation or inflation, 786-90.
on Enterprise, 828-31, 869, 874.
on Government rate of borrowing, 766-8.
on National credit abroad, 769-70, 871, 874.
on Private businesses, 791-801, 868.
Psychological, 870.
Redistribution of saving power, 803-9.
Redistribution of wealth, 832-6.
on Savings, 810-27, 869, 874.
on value of Securities, 750-64, 867, 873.
if Well received, 867-71.
Equity of:
Arguments against, 846-57.
Arguments for, 837-45.
Comparison with income tax, 872.
Conclusion, 858.
Exemption limit, 720-2, 852.
Experimental nature of, 765, 876.
Future level of prices as affecting argument for, 737-42.
Future war, possibility as affecting argument for, 860.
Graduation, estimated yield on different scales of, 723-5.
Introduction immediately after the war, argument stronger than at present, 739, 866.
not Justified by existing circumstances, 858, 872, 876.
Opponents of, arguments put forward by, 706.

Capital Levy—*cont.*
Payments:
by Instalments, 801, 868.
Methods of, 749-50, 755.
in Securities:
Lord Arnold's proposals, 755, 759.
Effects of, 749-55, 759, 763.
Physical achievement, scale of, 860-6.
Practicability, 708-17.
probable Reception of, 875.
(net) Relief to budget through reduced interest charge, 731-3.
Relief of direct taxes, 805-6, 808, 812, 815 *et seq.* 862-6, 869
Relief of indirect taxes, 805-6, 812, 834, 836, 861-6.
Repetition:
Fear of, 735, 744, 745, 869.
Guarantee against, difficulties of, and possible nature, 744-8, 811.
Saving of interest from, 726-30.
Scale, 723-5, 734-6.
Scope of:
Confinement to individuals, 719.
Physical wealth, limitation to, 719, 847-51.
and Social expenditure, 805-6, 834, 836, 861-6.
Success, dependence on attitude of taxpayer, 709, 717, 765, 859.
Valuation:
possible Inequalities in, 854-7.
Practicability, 711.
of Settled property:
Difficulties, 712, 713.
Estate duty system, possibility of, 713-6, 857.
Yield, estimates of, from different scales of graduation, 723-5.
Yield to be aimed at, 718, 725, 734-5.

Cheques:
Numbers used (1909-10 to 1925-26), 571.
Stamp duty on, *see that title.*

Cocoa, coffee, etc., duties:
Burden of, on specimen incomes (1903-4, 1913-14, 1918-19, 1923-24, 1925-26), 240, 243, 255.
Rate per head and consumption, 615, 624.

Companies:
Conversion of private businesses into, *see under* Business, private.
Distinction of private business from public companies, 409-11.
Formation of, effect on:
of Death duties, 504, 1022.
of Income tax, 404.
of Stamp duty, 568-70.
Joint stock, effect of income tax, 379-408.
Profits, estimates of total (1912, 1922, 1923), 48-9.
Reserves:
Comparison with pre-war, 48-53, 395, 402.
Effect of income tax on, 392-402.
Equity of taxing at standard rate, 398-9.
Estimate of:
(1922 & 1923), 48, 49, 396.
(1924), 47, 48.
Relief from income tax, question of:
Conclusion, 1019.
Sir A. Lowes Dickinson's proposal, 1016.
Effect on industries with high and with low profits, 1019.
Equity, 1017-8.
Practicability, 1016-9.
Private businesses, 419, 1017.
Share capital, stamp duty on, *see under* Stamp duties.

Conversions:
see under National Debt.

Conveyance of land, etc.:
Stamp duty on, *see under* Stamp duties.

Corporation Profits Tax:
Total net receipts, 1913-14 to 1925-26, 218*r*

Cost of living:
see Living, cost of.

Credit:
see also Advances *under* Banks.
Effect on supply of, and demand for, of capital levy, 771-90.

Customs and Excise duties:
see also Alcoholic drinks, *etc.*, *and* Indirect Taxation.
Burden of: 701.
on Specimen incomes (1903-04, 1913-14, 1918-19, 1923-24, 1925-26), 239-55, 594.
Effects of:
Area of, 1030.
Generally, 589-92.
on Prices, 580-8.
on Saving, 668-70.
on Standard of living, 659-67, 670, 690, 1029.
on Trade, 590-1, 670, 1030.
Incidence, 580-8.
Luxuries, high level considered justifiable, 701.
" Necessaries " and " luxuries," classification into, 615.
" Regression in," 595-6, 685-6.
Relation between wages and, 598-614.
Total net receipts, 1913-14 to 1925-26, 218.

Death duties:
Burden of, on specimen incomes (1903-04, 1913-14, 1918-19, 1923-24, 1925-26), 229-37, 255.
Earmarking of, for redemption of debt and other capital expenditure:
Arguments for, and against, 541-4.
Conclusion, 544.
Estate duty:
on Agricultural estates, 505-12, 547.
Avoidance of, 498, 545, 1022.
Burden of, 469-74.
Effects of:
on Capital supply, 514-34, 544, 547.
Comparison with effects of income and super-tax, 513, 517-34, 542, 544, 546-7.
on Enterprise, 513, 521-34, 547, 695.
on Saving, 513-20, 525-34, 547.
Equity of: 475-95.
Changes in scale of duty, 489.
Fluctuations in security values, 486-8.
Indefinite variation in history of estates, 485.
from Successor's point of view, 490-4.
Value of capital basis, 476-9.
Varying frequency of deaths, 481-4.
Exemption of beneficial owners of Government loans not ordinarily resident in the United Kingdom, 175-6, 178-9.
Incidence, 452-60.
Inclusion of sums received from life insurance in value of estate, 496-7, 1021.

Death Duties—*cont.*
Estate duty—*cont.*
on Private businesses, 499-504, 524, 527.
Rate:
on Large estates, dangerously high, 498.
on Largest estates, moderation might be desirable, 1023.
Post-war, 464-70.
Inheritance tax:
Arguments in favour of principle, 490-4.
View on substitution for Estate Duty, 1023.
Views on extension of principle, 1024-7.
Legacy and Succession duties:
Development of, 1025-7.
Graduation, 535, 537.
Incidence of, 461, 536.
Nature of and basis, 535-6, 539-40, 548.
Yield of, 1924-25, 538.
Merits and demerits, diversity of opinion *re*, 462.
Rignano scheme:
Comparison with Dr. Dalton's scheme of terminable annuities, 930.
Effects on savings, 927.
Examination of, and conclusion, 921-8.
Inequities of, 925-6.
Practicability question, 924.
Tendering of securities in payment, 180, 181, 210, 212.
Terminable annuities scheme, examination of, 929-34.
Total net receipts, 1913-14 to 1925-26, 218.

Direct Taxation:
see also Death Duties, Income Tax, etc.
Advantages and disadvantages compared with indirect taxation, 685-6, 688.
Burden, 581-8, 702.
Effects:
on Prices, 702.
Psychological, 702.
on Saving, 702.
per Head (1913-14, 1914-15 and 1920-21 to 1925-26), 219.
Progressive nature of, 685-6.
Proportion to indirect taxation:
(1913-14, 1914-15 and 1920-21 to 1925-26), 219.
Fixed proportion, question of, 693.
Total burden of, on specimen incomes (1903-4, 1913-14, 1918-19, 1923-24, 1925-26), 255.

Enterprise:
Effect on:
of Capital Levy, 828-31, 869, 874.
of Estate duty, 513, 521-34, 547, 695.
of Income and super-tax, 343-50, 403-4, 416-34, 445-51, 694-5.
of Taxation generally, 979.

Entertainments Duty:
see also Customs and Excise duties.
Burden of, on specimen incomes (1918-19, 1923-24, 1925-26), 253, 254, 255.
Effects generally, 658.
Rates, 655-6.
Revenue from (1916-17 to 1925-26), 657.
Total net receipts and duty per head (1923-24, 1924-25, 1925-26), 593.

Estate Duty:
See under Death Duties.

Excess Profits Duty:
Total net receipts, 1913-14 to 1925-26, 218.

Expenditure, National:
Death duties and, 541-4.
on Debt service, *see under* National Debt.
on Defence, 282.
Due proportion of, must be devoted to capital and productive purposes, 544.
Economy, value of debt-charge as incentive, 861.
Effects of, and extent of burden, 280-7, 684.
New, in relation to sinking fund policy, 1002.
on Pensions, 280-1.
Proportion of various kinds of, to national income (1818, 1913, 1923), 676-8.
Social, 283-5.

Export Trade:
Decline in reserves, 51-3, 402.
Depression, general causes, 402, 702.
Effect of income tax, 402.

Floating debt:
see under National Debt.

Forced loan:
Comparison with capital levy, 895.
Examination of a scheme, 878-92.
Views on, 893-4.

Foreign investment in England:
Effect of income tax on, 391.

Gilt-edged securities:
see under Securities.

Income Tax and Super Tax:
Burden of, on specimen incomes (1903-4, 1913-14, 1918-19, 1923-24, 1925-26) 224-8, 255.
Composition for future liability, examination of schemes, and objections to, 906-11.
Double, effects of, 407, 408, 436, 443.
Earned income relief, 356-7, 362, 1014-5.
Effects of:
on Capital supply, 380-91, 444, 447, 448.
on Company reserves, 392-402.
Comparison of effects of estate duty with, 513, 517-34, 542, 544, 546-7.
on Enterprise, 343-50, 403-4, 416-34, 445-51, 694-5.
on Export trade, 402.
on Foreign investment in England, 391.
on Formation of companies, 404.
"Physical" and "Psychological", 326.
Prevention of residence in the United Kingdom, 407, 408.
on Price level, 438.
on Private business, 416-36, 443.
Redistribution of saveable income, 380.
Residence abroad, 342, 405-6, 435-6.
on Saving, 365-77, 380-9, 416-23, 429-32, 440-4, 1015.
on Standard of living, 44, 351-64, 439.
on Work and enterprise of employee and professional man, 343-50.
Elasticity of, 1012.

Income Tax and Super Tax—*cont.*
Equity, comparison with capital levy, 872.
Exemption of beneficial owners of Government loans not ordinarily resident in the United Kingdom, 171, 175-6, 179.
Family allowances, 1014-5.
Incidence of:
Conclusion, 324-5.
Economic argument, 293-309, 324.
Evidence received *re*, 293-6.
Hypothetical cases, 310-14.
Monopoly production, 299-304.
Prices, importance of question in relation to, 293.
Tax on profits, 299-304.
Tax on wages and salaries, 297-8.
Investment income, increased tax on, examination of proposal for, 902-5, 1015.
Loans with interest tax—compounded, 177,179.
Non-deduction at source on Government loans, effect of, 172, 174, 179
Post-war rates and graduation, 334-41.
Progressive principle, 330-3.
Special privileges attached to Government loans, 171-81.
Standard rate, reduction of, and revision of graduation, Mr. Keynes' proposal, 1020.
Standard rate and net produce of (1919-20 to 1925-26), 334.
Total net receipts (1913-14 to 1925-26), 218
Universal, objections to, 686.

Indirect Taxation:
see also Customs and Excise duties.
Advantages and disadvantages of, compared with direct taxation, 685-6, 688.
Area of, 1030.
Burden, 701.
Effect on trade, 590-1, 1030.
per Head (1913-14, 1914-15 and 1920-21 to 1925-26), 219.
Proportion to direct taxation (1913-14, 1914-15 and 1920-21 to 1925-26), 219.
Fixed proportion, question of, 693.
Regressive nature of, 685-6.
Total burden of, on specimen incomes (1903-04, 1913-14, 1918-19, 1923-24, 1925-26), 255.

Inhabited House Duty:
now Abolished, 238.
Burden of, on various incomes, 238, 255.
Total net receipts (1913-14 to 1925-26), 218.

Insurance, life:
Encouraged by income tax laws, 58.
Inclusion of sums received from, in value of estate for death duties, 496-7, 1021.

Investment income:
Increased taxation of, examination of proposal for, 902,5, 1015.

Joint Stock Companies:
See Companies.

Land Tax:
Total net receipts, 1913-14 to 1925-26, 218.

Land Values Duties:
Total net receipts, 1913-14 to 1925-26, 218.

Legacy Duty:
See under Death Duties.

Living:
Cost of, Index figures (1914 and 1920-1925), 18-20.
Standard of:
see also Wages.
since 16th century, 11.
Adequate, relative nature of, 10.
Changes in direction of expenditure, 40-2.
Comparison with pre-war, 13-43.
Consumption, comparison with pre-war, 37.
Effects on:
of Customs and Excise duties, 659-67, 670, 690, 1029.
of Income tax, 351-64, 439.
of Taxation generally, 690.
Evidence received *re*, 38.
during and after Napoleonic wars and comparison with 1914-18 and since, 12.
Spending, comparison with pre-war, 59.

Loans, issue of, at heavy discount:
see under National Debt.

Munitions, Exchequer Payments:
Acceptance of National War Bonds in payment, 180.

National Credit, effect on:
of Capital Levy, 766-70, 871, 874.
of Steady annual reduction of debt, 966, 967.

National Debt:
See also Capital Levy.
Amount:
(1818, 1864, 1875, 1891, 1913), 679.
(1914, 1920 and 1926), 67, 68, 70.
Burden:
Comparison with post-Napoleonic war period, 676-9.
Future, 683.
Charge (1818, 1864, 1875, 1891, 1913), total and per head, 679.
Conversions:
in Future, question as to possibility of saving from, 188-96, 202, 1007.
of Loans maturing up to 1932, Mr. Hoare's scheme, 943-7.
Operations, results of, 129-43, 154.
Options, 131-3.
in Response to new offers, 134-42.
3½ per cent. Conversion loan, 124-7, 135, 137, 138, 154, 158, 163, 170, 210, 212, 214.
4½ per cent. Conversion loan, 140, 142, 170.
Specific sinking fund, Dr. Dalton's suggestion, 216.
External:
American:
Funding arrangements, payments of principal, 210, 212, 213.
Interest, charge (1920-21 and 1925-26), 182, 183, 185.
Present position, 88-91.
Amount (1920, 1926), 68.
Borrowings and repayments (1920-21 to 1925-26), 122-7.
Burden, and comparison with burden of internal debt, 71-86, 259.
Distinction from internal debt, 71-86.
Interest charge (1919-20, 1925-26), 69, 91.
Present position of, 87-92.
5 per cent. War Loan 1929-47, depreciation fund, 210, 212, 214.

National Debt—*cont.*
Floating debt:
Advantage of, 98.
Amount, evidence received *re*, 98-100.
Amounts outstanding various dates, 1916 to 1926, 95.
Dangers and disadvantages of, 99-101.
Reduction, views as to, 102-4.
Treasury bills:
Amount:
(1914, 1920, 1926), 67, 68.
(1916 to 1926), 95.
Creation and redemption (1920-21 to 1925-26), 121, 123-7.
Holders, 97.
Interest charge:
(1919-20, 1925-26), 69.
(1920-21 and 1925-26), 183, 184, 187.
Ways and Means Advances:
Amount:
(1916 to 1926), 95-6.
(1920, 1926), 68.
Creation and redemption, 122-5.
Interest charge:
1919-20, 1925-26, 69.
1920-21 and 1925-26, 183, 184, 187.
Form of Loan issues:
Form of security to be issued, question of, 1008-11
Issue at figure not very appreciably below par, 170, 1008.
Issues at heavy discount, examination of, 155-70.
4 per cent. Funding Loan, 1960-90, sinking fund, 210, 212, 213.
4 per cent. Victory Bonds, sinking fund, 210, 212, 213, additional specific sinking fund, Dr. Dalton's suggestion, 216.
4 per cent. War Loan (tax compounded) 1929-42, depreciation fund, 210, 212, 214.
Funded debt:
Amount (1914, 1920, 1926), 67, 68.
Interest charge (1919-20, 1925-26), 69.
Nature of, 64.
Interest:
Charge:
(1919-20, 1925-26), 69, 70.
(1920-21 and 1925-26) and causes of reduction, 182-8.
Payments, 1920-21 and 1925-26, details, 183-7.
Internal:
Effects of:
on Distribution of wealth, 75, 93, 260–79.
on Savings, 93, 263-72, 275.
Holders of, 263.
Interest, and relation to budget receipts, 1913-14 to 1925-26, 94.
Position, 31st March, 1920, 107, 108.
Redemption, *see that title below.*
Reborrowings and repayment since 1st April, 1920, 120–8.
Redemption:
(1920–21 to 1925–26) 109–19, 122–7.
Allocation of principal repayments of Allied war debts to, 999.
Annuities running for life or fixed term of years, Mr. Strachey's proposal, 941–2.
Budgetary provision for, 1920–21 to 1925–26, 110–5, 118.
Burden of, relation to changes in price level, 197–202.
Earmarking of death duties for, arguments for and against, 541–4.
Effects of great transfer of Capital due to big redemption scheme, 977.

National Debt—*cont.*
Redemption—*cont.*
Effects of:
on Bank advances, 981–4.
on Credit, 981–4.
on Distribution of wealth, 279, 387.
on Foreign investment, 278, 385–6, 980.
on National credit, 966–72.
on National Savings, 274–8, 979.
Forced loan scheme, examination of, 878-94.
Linking-up of, with policy for diminution of unemployment, Prof. Bowley's scheme, examination of, 948-63.
Rate:
no Formula possible, 995.
Possibility of future emergency, 973–4.
Rapid, displacement of capital by, according to Mr. McKenna, 977, 980.
Regulation, formulas proposed by witnesses, and difficulties of, 986-8.
Summary of evidence *re*, 986–94.
miscellaneous Receipts applicable to, 116–9.
Continuance, 1003.
Recommendations *re*, 1000-6.
Regulation of, according to demand for gilt-edged securities, Mr. Keynes' contentions, 978, 979, 980.
Sinking funds, *see that title.*
Steady annual reduction, advantages of, 966-75.
Steady and regular policy, importance of, 1005.
Summary of evidence *re*, 976-85.
Sustained efforts necessary, 995.
Terminable annuities, examination of scheme, 935–41.
Variation according to state of trade, 1006.
Service, expenditure on (1818, 1913, 1923), and proportion to national income, 676-8, 684.
Special taxation privileges attached to loans, 171-81, 1008.
Terminable annuities, 65.
Amount, 1914, 1920, 1926, 67-68.
Interest charge, 1919-20, 1925-26, 69.
Sinking fund, 210, 212.
Transactions, summary of, 1920-21 to 1925-26, 144-154.
Unfunded debt:
Amount, 1914, 1920, 1926, 67-8.
Interest charge, 1919-20, 1925-26, 69.
Nature of, 66.

National Income:
(1818, 1864, 1875, 1891, 1913) total and per head, 679.
and Proportion of national expenditure to (1818, 1913, 1923), 676-8.

National Savings Certificates:
Conversion offer, 195.
Encashment, 1920-1 to 1925-26, 122-7.
Interest:
Accumulated liability:
31st March, 1926, 70, 998.
Provision for, in budget, question of, 998.
Charge (1920-21, 1926-26), 183, 186.
Issues, 1920-21 to 1925-26, 121, 123-7.
Statistics, no safe guidance as to working-class savings, 57.
Treatment of, in Accounts, 998.

Population:
Age and sex distribution (1911, 1921), 39.
Family, size of, comparison with 1914, 39.
Future, estimates of, 680, 699.

Prices:
Determination of, 293-324 (*passim*).
Effect on:
of Direct taxation, 702.
of Income tax, *see under* Income tax, Effects of *and* Incidence of.
of Indirect taxation, 580-8.
Future level of:
in Connection with capital levy, 737-42.
Evidence received *re*, 202, 740-2, 975.
Relation of burden of debt repayment to changes in, 197-202.

Production:
Comparison with pre-war, 44.
Flat-rate tax on, examination of proposal for, 912-20.
Future productivity question, 680-3, 995.
per Head per hour, comparison with pre-war, 26.

Profit and Profits:
Determination of, 293-324 (*passim*).
in Monopoly trade, 300-4.
Rate of, conventional, 428.
Statistics of total company profits (1912, 1922, 1923), 48-9.
and Turnover, percentage relation in various trades (1920-1, 1922-3), 307 (1912-13, 1922-3), 309.
Undistributed, *see* Reserves *under* Companies.

Receipts:
Stamp on, *see under* Stamp duties.

Redemption of Debt:
see under National Debt.

Rignano scheme:
see under Death duties.

Saving and Savings:
Comparison with pre-war:
Generally, 45-60.
new Home issues for industrial purposes and investment abroad, 55, 56.
Undistributed trade profits, 48-55.
Definition, 328.
Effects on:
of Annual tax on capital, 899.
of Capital levy, 810-27, 869, 874.
of Customs and Excise duties, 668-70.
of Debt interest payment, 260-5.
of Debt repayment, 274-8, 979.
of Direct taxation, 702.
of Estate duty, 513-20, 525-34, 547.
of Income tax, 365-77, 380-3, 416-23, 429-32, 440-4, 1015
Increased taxation of investment income, 904, 1015.
of Rignano scheme, 927.
of Taxation generally, 691-3.
of Income tax paying class, 58.
National:
1924 estimate by Mr. Coates, 47.
Total, comparison with pre-war, 45-60.
and Needs of increasing population, 696-700.
Redistribution of power, by capital levy, 803-9.
of Working class, 57.

Savings Certificates:
see National Savings Certificates.

Securities:
Effects of capital levy on value of, 751-64, 867, 873.
Gilt-edged, demand for, Mr. Keynes' proposal that debt redemption should be regulated according to, 978-80.
Payment of capital levy in, *see under* Payment *under* Capital Levy.
Tendering of, in payment of death duties and excess profits duty, 180, 181, 210, 212.

Sheltered industries:
Wages, 24, 43.

Sinking Funds:
Development of, 203-15.
New (1875), history of, 205-8.
New (1923):
Allocation of, 1924-25 and 1925-26, 212.
Amount:
£50 Million, adequacy, views on question of, 977-1000.
Increase:
to £75 Millions, recommendation for, within five years, 1001.
to £100 Millions, recommendation, 1002.
proposed Statutory provision for, 1005.
Summary of evidence *re*, 989-94.
Approximate Provision for 1926-7, 1930-1, 1940-1, 1950-1, 213-5.
Establishment of, and increase, 113-5.
Old, history of, 204.
Raiding of:
Risk would be increased by Prof. Bowley's debt redemption scheme, 961.
Safeguarding question, 1005.
Redemption of debt through, advantage of, 968.
Specific:
Advantages of, up to the present, 217, 1005.
Dr. Dalton's suggestion, 216.
Extension of system not advocated, 217, 1005, 1008.
Particulars of, 209-15.

Social Services:
Generally, 283-5.
Increase in, 32, 43, 684, 861.

Spirits duty, *see* Alcoholic drinks duty on.

Stamp duties:
on Bearer bonds:
Criticisms by witnesses, and comments on, 564.
Effect on foreign loan issues in United Kingdom, 564-5, 1028.
Incidence, 563.
Rate of duty, 562.
Yield (1918-19 to 1925-6), 562.
on Cheques:
Criticisms by witnesses, and comments on, 573-5.
Incidence, 572.
Rate of duty, 571.
Yield, 1909-10 to 1925-26, 571.
on Companies' share capital:
Criticisms by witnesses, and comments on, 568.
Effect on amount of capital registered, 568, 570.
Effect on formation of companies, 568-70.

Stamp duties—*cont.*
on Companies' share capital—*cont.*
Incidence, 567.
Rate of duty, 566.
Yield, 1918-19 to 1925-26, 566.
on Conveyance of land, etc.:
Criticisms by witnesses and comments on, 555–7.
Incidence, 554.
Rate of duty, 553.
Yield (1918–19 to 1925–26), 553.
History of, 549.
on Receipts:
Criticisms by witnesses and comments on, 578.
Incidence, 577.
Rate of duty, 576.
Yield, 576.
Total net receipts, 1913-14 to 1925-26, 218.
on Transfer of stocks and shares:
Criticisms by witnesses and comments on, 560-1.
Incidence, 559.
Rate of duty, 558.
Yield (1918-19 to 1925-26), 558.
Views of Committee on duties generally, 551, 579, 1028.
Yield (1818, 1813-14, 1915-16, 1917-18, 1925-26), 549, 550.

Standard of Living:
see Living, standard of.

Stocks and shares:
Transfer of, stamp duty on, *see under* Stamp duties.

Succession Duty:
see under Death Duties.

Sugar, etc., duty:
see also Customs and Excise duties.
Burden of, on specimen incomes (1903-4, 1913-14, 1918-19, 1923-24 1925-26), 240, 243, 255, 631.
Rates of duty, retail prices and consumption and duty per head, 1913-14 to 1925-26, 625-30.
Total net receipts and duty per head, 1913-14, 1923-24 to 1925-26, 593.
Views of Committee, 690, 701, 1029.

Super tax:
see Income tax and Super tax.

Taxation:
see also under the several taxes.
Burden:
Comparison with other countries, impracticability of, 673-5.
Comparison with post-Napoleonic war period, 676-8.
General, 701, 702.
on Specimen incomes (1903-4, 1913-14, 1918-19, 1923-24, 1925-26), 255.
Method of dealing with, 220-3.
Connection with representation argument, 686, 688.
Distribution, General character of post-war, 693.
Incidence:
General considerations, 289-92.
Use of term as distinct from "effects," 288.
Increase, views of Committee on question of, 1000-2, 1012.
Total net receipts (1913-14 to 1925-26), 218.

Tea duty:
see also Customs and Excise duties.
Burden of, on specimen incomes (1903–4, 1913–14, 1918–19, 1923–2 1925–26), 240, 243, 255, 623.
Rates of, retail prices, and consumption and duty per head, 1913-14 to 1925-26, 616-23.
Total net receipts and duty per head, 1913-14 and 1923-24 to 1925-26, 593.

Terms of reference:
Interpretation of, 5-7.

Tobacco duty:
see also Customs and Excise duties.
Burden of, on specimen incomes (1903–4, 1913–14, 1918–19, 1923–24, 1925–26), 241–2, 244–7, 255, 636, 637.
Rates of, retail prices and consumption and duty per head from 1913-14, 632–6.
and Standard of living, 661, 667.
Total net receipts and duty per head, 1913-14, 1923-24 to 1925-26, 593.

Treasury Bills:
see under Floating debt *under* National Debt.

Turnover tax:
Objections to, 1031.

Unemployment or short time employment:
Increase, effect on average wages, 28, 31, 43.
Linking up of debt redemption with policy for diminution of, examination of Prof. Bowley's scheme, 948–63.
Statistics (1923, 1924, 1925, 1926), 28.

United States of America:
Debt due to, *see* External debt *under* National Debt.

Wage earners:
earnings of, in relation to total production and national income, 44.

Wages:
Average:
Effect of unemployment and short time on, 28, 31, 43.
for Employed wage-earners:
Generally, 14-21.
in Particular industries, 22-7, 43.
Earnings:
Comparison with pre-war, 22-7, 34, 43.
of Piece workers, increase greater than increase in piece rates, 22, 24-5.
Rates, course of, since the war and comparison with pre-war level, 13-21.
Relation between customs and excise duties and, 598-614.

Ways and Means advances:
see under Floating debt *under* National Debt.

Wealth; distribution of, effects on:
of Capital levy, 832-6.
of Debt interest and repayment, 75, 93, 260–2, 266–73. 279, 387.

Wine, Duty on:
see Alcoholic drinks, duty on.

(49088—22) Wt. 13344—4305 7000 2/27 H. St (4 71

00108865

CX. P. 5

Report of the Committee on National debt & Taxation

Digitized with financial assistance from the
Government of Maharashtra
on 26 June, 2018